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THIRD DIVISION

[G.R. No. 190385, November 16, 2016]

UCPB GENERAL INSURANCE COMPANY, INC. PETITIONER, VS. HUGHES ELECTRONICS CORPORATION, RESPONDENT.

DECISION

PEREZ, J.:

Before this Court is a Petition for Review on *Certiorari*[1] filed by UCPB General Insurance Company, Inc. (UCPB Insurance), assailing the 19 March 2009 Decision[2] and 23 November 2009 Resolution[3] of the Court of Appeals (CA) in CA-G.R. CV No. 89788 upholding the 15 March 2007 Decision[4] of the Regional Trial Court (RTC) of Makati City, Branch 137 ordering UCPB Insurance to pay the respondent Hughes Electronics Corporation (Hughes Electronics) the amount of US$683,457.95 less the amount of US$60,000.00 plus interest, subject to indemnification from One Virtual Corporation (OVC) and Mel V. Velarde (Velarde).[5]

The facts, as we gathered from the records, are:

On 30 September 1998, the Philippine Charity Sweepstakes Office (PCSO) issued Resolution No. 1438 approving the use in its lottery operations a facility called Very Small Aperture Terminal lines (VSAT lines) being offered by domestic corporation One Virtual Corporation (OVC), then called as Sun-O-Telecom.[6]

Hughes Electronics, upon acquiring knowledge of PCSO's resolution, offered OVC its VSAT equipment and services. To formalize their transaction, Hughes Electronics and OVC, on March 26, 1999, entered into a contract whereby Hughes Electronics agreed to provide the latter with the equipment and services necessary to establish, install and commission a Ku-band Satellite Communication Network (the Integrated Satellite Business Network or J.SBN) consisting of a hub earth station, hub baseband equipment and Buyer-specified number of Personal Earth Stations (PESs). The ISBN will consist of all hardware, software and services required to establish a complete operational system that meets the technical and functional specifications set forth in the Technical Specifications to the contract.[7] By way of payment, Hughes Electronics and OVC agreed that the consideration will be US$743,457.95 secured by OVC's standby letter of credit issued in favor of Hughes Electronics.

On 26 March 1999, the terms of payment were modified upon issuance of a surety bond with OVC as principal and UCPB Insurance as surety in favor of Hughes Electronics. The surety bond guaranteed the payment of 95% of the purchase price of the ISBN. To further secure the payment, Mel V. Velarde, the Chairman and CEO of OVC, executed an Agreement of Counter-Guaranty[8] in his personal capacity in favor of UCPB Insurance. In the said counter-guaranty, he and OVC jointly and severally undertook to indemnify UCPB Insurance for any damages, prejudice, loss, cost, payment advances and expenses of whatever kind and nature, including a twelve percent interest (12%) *per annum* from judicial or extra-judicial demand and attorney's fees which the latter may, at any time, sustain or incur as a consequence of having executed said surety bond. The said indemnity will be paid to UCPB Insurance as soon as demand is received from the obligee, or as soon as it becomes liable to make payment of any sum under the terms of the surety bond.[9]

By way of down payment, OVC paid Hughes Electronics the amount of US$60,000.00. However, subsequent schedules of payment were not complied with.

On 7 October 1999, OVC requested for a revision of the terms of payment which Hughes Electronics granted subject to the condition that the revised terms would become effective upon issuance of a revised surety bond. On 25 October 1999, UCPB Insurance sent a letter to Hughes Electronics manifesting its conformity with the revised terms, as follow.[10]

1. The US$294,923.04 will not be paid on October 26, 1999.

2. Agreed revisions shall have the payment amounts on the following dates:

a.	October 30, 1999	US$30,000.00
b.	November 30, 1999	50,000.00
c.	December 15, 1999	67,461.52[11]

3. The balance of US$147, 461.52 plus interest at LIBOR[12] plus 3% shall be added to the scheduled April 2000 semestral payment.[13]

On 21 December 1999, before the expiration of the warranties in the contract, OVC informed Hughes Electronics that the ISBN system currently installed at its Napa hub facility did not support the *Burroughs poll/select protocol*. Thus, it demanded from Hughes Electronics an explanation and immediate solution of the problem.[14]

Meanwhile, OVC failed to pay Hughes Electronics in accordance with the revised payment terms. As a result, Hughes Electronics sent a letter to UCPB Insurance on 11 October 2000, demanding for the value of surety bond which, less the down payment of US$60,000.00 amounting to US$683,457.95. Upon failure to heed its demand, Hughes Electronics sent another demand letter to UCPB Insurance on 17 October 2000.[15]

Still, upon OVC's failure to pay, Hughes Electronics, on November 10, 2000, filed a Complaint for Sum of Money with Damages against OVC as the principal and UCPB Insurance based on the surety bond it issued to guaranty the payment of the obligation of the principal OVC.[16] In the said complaint, Hughes Electronics prayed for the following:

[a.] For the amount of US$683,457.95, representing the balance of the contract price as stipulated in the contract and under the surety bond, plus interest twice the ceiling prescribed by the Monetary Board from the date of demand[;]

[b.] The amount of [US$100,000.00] as exemplary damages.

[c.] The amount of [US$5,000.00] and 10% of all amounts recovered as and by way of attorney's fees.

[d.] To pay the costs ofsuit.[17]

On 11 December 2000, UCPB Insurance filed its Answer with Special and Affirmative Defenses, Cross-Claim and Compulsory Counterclaim. In its special and affinnative defenses, UCPB Insurance alleged that it is not liable for any contingent liability under the surety bond since both Hughes Electronics and OVC deviated from the tenns and conditions of the contract and of surety bond without its written consent. It further alleged the failure of Hughes Electronics to provide OVC the equipment and components needed to conform to the system for which the said materials were purposely purchased. In its Cross-Claim, UCPB prayed that, in case of unfavorable judgment, OVC and Velarde be directed to indemnify the company of whatever amount it may be ordered to pay Hughes Electronics. Finally, by way of compulsory counterclaim, UCPB Insurance prayed for recovery of corrective and exemplary damages.[18]

In the amendment of its Answer, UCPB Insurance filed a Third-Party Complaint against Velarde based on the Agreement of Counter-Guaranty.[19] It also argued that the contract stipulated an arbitration clause and Hughes Electronics overlooked said co'ndition of the agreement before filing a case in court. UCPB Insurance alleged that:

> 26. Further, the contract, Annex "A" stipulates an arbitration clause; and it appears plaintiff has overlooked said condition of the agreement; and since the instant action directly involves the issue of whether or not [the] plaintiff had clearly complied with its undertaking under the agreement, Annex "A" to complaint, said basic issue should first be resolved before the instant action is given due course. Therefore, the instant action is premature and should be dismiss[ed]. Even assuming that it was seasonably filed, the parties in this case should consider thearbitration clause, otherwise, plaintiffs filinthe instant case could be construed as waiving the arbitration process[.][20]

On 27 December 2000, OVC filed a Motion to Dismiss and argued that Hughes Electronics had neither legal capacity to sue nor cause of action to file a complaint and that the condition precedent for filing the claim, which is the referral to arbitration has not been complied with. The motion was denied on March 6, 2001. OVC then moved for reconsideration, but the same was denied on August 10, 2001.[21] The denial was elevated to theCA through a Petition for *Certiorari*.

On 11 September 2001, OVC filed its Answer reiterating its arguments in the Motion to Dismiss. By way of compulsory counterclaims, OVC alleged that since Hughes Electronics committed a breach of contract, the contract should be rescinded and the US$60,000.00 it had already paid be reimbursed. Further, it sought for moral and exemplary damages, attorney's and appearance fees· in the amount of P300,000.00, P100,000.00, P100,000.00 and P1,500.00 per hearing, respectively, against Hughes Electronics.[22]

Meanwhile, the Petition for *Certiorari* previously filed before the appellate court was denied on November 19, 2001 due to some formal defects.[23]

On 5 April 2002, Velarde filed his Answer to the Third-Party Complaint and argued that UCPB Insurance has no cause of action against him. He also alleged that the third-party complaint was premature and the true agreement between him and UCPB Insurance was to require an exhaustion of remedies against OVC before any suit in court can be filed.[24]

After the trial on the merits, the trial court, on 15 March 2007 rendered its decision in favor of Hughes Electronics, the dispositive portion of which reads:

> **WHEREFORE**, premises considered, judgment is hereby rendered:
>
> (1) Ordering defendant/third-party plaintiff UCPB General Insurance Company Inc., to pay plaintiff Hughes Electronics Corporation the amount of US$683,457.95, representing the value of the Surety Bond, less the amount of US$60,000.00 previously paid to the plaintiff by defendant/cross-defendant One Virtual Corporation plus interest to be reckoned in accordance with the stipulations in the Contract between HEC and One Virtual Corporation, particularly under Section IV (B);
> (2) Ordering defendant/cross-defendant One Virtual Corporation and third-party defendant Mel V. Velarde to indemnify, jointiy and severally, defendant/third-party plaintiff UCPB General Insurance Company, Inc. of whatever amount the latter may pay plaintiff Hughes Electronics Corporation, plus interest at the rate of 12% per annum reckoned from the date when UCPB filed its CrossClaim against One Virtual Corporation and the Third-Party Complaint against Velarde; attorney's fees of P250,000.00; and costs of litigation in the amount of P50,000.00.
>
> SO ORDERED.[25]

Aggrieved, UCPB Insurance filed a Notice of Appeal to reverse the decision of the trial court.[26] In its Appellant's Brief, it alleged several assignment of errors primarily arguing that the trial court erred in not dismissing the case for being premature since Hughes Electronics disregarded a stipulated agreement to submit all disputes arising from the contract to arbitration. Further, it submitted that the trial court erred when it failed to consider that since Hughes Electronics failed to comply with its obligation to deliver a functioning equipment, its right to demand payment from OVC was premature. Finally, UCPB Insurance alleged deviation in the terms and conditions of the surety contract, resulting in the discharge of its obligation to pay.[27]

In its Appellee's Brief, Hughes Electronics refuted the claim of UCPB Insurance. It alleged that referral to arbitration was not a condition precedent to any judicial action. Further, it denied that the contract required the company to deliver *burroughs protocol* or the PCSO lotto protocol. Finally, Hughes Electronics insisted that since UCPB Insurance bound itself to be solidarity liable with OVC, it cannot deny its obligation to pay in case of OVC's default.[28]

On 19 March 2009, the CA affirmed *in toto* the challenged decision of the trial court. [29]

In dismissing the appeal, the CA relied on its finding that the arbitration clause in the contract is permissive in character. It also affirmed the argument of Hughes Electronics that nothing in the contract expressly stipulated that ISBN should specifically support the *burroughs protocol* of the PCSO before the obligation of the ave to pay the balance of the purchase price arises. Further, it ruled that ave cannot unilaterally suspend the payment of the balance of the purchase price without recourse to the provisions of the Civil Code on the rescission of contracts. Finally, it affirmed the findings of the lower court that a surety contract, though an accessory one, binds the surety UCPB Insurance solidarily.[30]

UCPB Insurance before this Court presented the following issues:

> I. Whether or not the arbitration clause in a contract is a condition precedent to be complied with before resort to legal action;
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> II. Whether or not the· failure of the Seller to comply with the provisions of the Contract relieves the surety of its obligation under the suretyship;
>
> III. Whether or not deviations from the principal contract will relieve the bondsman from its suretyship obligation.

At the outset, we note that the contract between Hughes Electronics and ave provided a specific provision on dispute resolution to govern the parties in case of disagreement or any breach of contract. As provided under Title XIII thereof:

> XIII. <u>DISPUTE RESOLUTION</u>
>
> Any and all disputes arising under or in connection with this Agreement or any breach hereof shall be resolved in accordance with this Section.
>
> A. Negotiation
>
> The Parties shall attempt to resolve any dispute, controversy or difference, which may arise between them through good faith negotiations. In the event the Parties fail to reach resolution of such dispute within sixty (60) days of entering into negotiations, either Party may refer such dispute to arbitration pursuant to the provisions of Sec. B, below. Notwithstanding the above, the Parties may elect to waive applicability of this section if (i) both Parties agree in writing that the nature of their dispute is such that it cannot be resolved through negotiations or (ii) if a Party shall suffer irrevocable harm by such delay.
>
> B. Arbitration
>
> Arbitration shall be conducted in accordance with the International Arbitration Rules of the International Chamber of Commerce (ICC) in effect at the time of the arbitration. The arbitration shall be in accordance