

## 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<sup>[1]</sup> (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).<sup>[2]</sup>

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.<sup>[3]</sup> 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.<sup>[4]</sup> 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.<sup>[5]</sup>

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.<sup>[6]</sup> 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.<sup>[7]</sup>

Petitioner Philguarantee approved respondents' application. Subsequently, letters of guarantee<sup>[8]</sup> 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.<sup>[9]</sup>

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<sup>[10]</sup> (Performance Bond Guarantee) in the amount of ID271,808/610 and Letter of Guarantee No. 81-195-F<sup>[11]</sup> (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<sup>[12]</sup> 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<sup>[13]</sup> 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.<sup>[14]</sup>

On 11 June 1981, SOB and the joint venture VPECI and Ajyal executed the service contract<sup>[15]</sup> 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.<sup>[16]</sup>

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.<sup>[17]</sup> The surety bond was also extended for another period of one year, from 12 May 1982 to 12 May 1983.<sup>[18]</sup> The Performance Bond was further extended twelve times with validity of up to 8 December 1986,<sup>[19]</sup> 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.<sup>[20]</sup> The surety bond was likewise extended to 8 May 1987.<sup>[21]</sup>

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.<sup>[22]</sup>

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.<sup>[23]</sup> 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.<sup>[24]</sup> Subsequently, 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.<sup>[25]</sup>

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.<sup>[26]</sup>

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."<sup>[27]</sup>

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.<sup>[35]</sup>

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.<sup>[36]</sup>

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