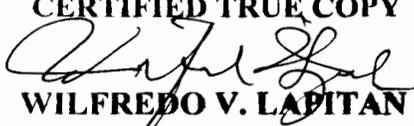




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WILFREDO V. LAPITAN
 Division Clerk of Court
 Third Division

DEC 09 2016

Republic of the Philippines
Supreme Court
 Manila

THIRD DIVISION

**UCPB GENERAL INSURANCE
 COMPANY, INC.**

G.R. No. 190385

Petitioner,

Present:

- versus -

VELASCO, JR.,* *J.*,
 PERALTA, *Acting Chairperson*,
 BERSAMIN,**
 PEREZ, and
 REYES, *JJ.*

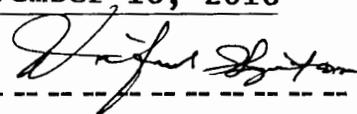
**HUGHES ELECTRONICS
 CORPORATION,**

Promulgated:

Respondent.

November 16, 2016

X



X

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 Decision² and 23 November 2009 Resolution³ of the Court of Appeals (CA) in CA-G.R. CV No. 89788 upholding the 15 March 2007 Decision⁴ of the Regional Trial Court (RTC) of Makati City, Branch 137 ordering UCPB Insurance to pay the respondent Hughes Electronics

* On Wellness Leave.

** Designated as Additional Member in lieu of Associate Justice Francis H. Jardeleza, who takes no part per Raffle dated June 13, 2016.

¹ *Rollo*, pp. 11-40.

² *Id.* at 46-61; penned by Associate Justice Josefina Guevara-Salonga with Associate Justices Arcangelita M. Romilla-Lontok and Romeo F. Barza, concurring.

³ *Id.* at 64-65; *id.*

⁴ *CA rollo*, pp. 121-135.



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 ISBN) 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-Guaranty⁸ 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

⁵ Supra note 1, Petition for Review on *Certiorari*; and supra note 2, CA Decision.

⁶ *Rollo* p. 58; CA Decision.

⁷ *Id.* at 90; Scope of Work, Annex A-2 of the Contract; CA *rollo*, pp. 121-122; RTC Decision.

⁸ *Id.* at 122-124; Annex G.

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 LIBOR¹² 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

⁹ *Rollo*, pp. 194-195; RTC Decision.
¹⁰ *Id.* at 16; Petition for Review on *Certiorari*.
¹¹ *Id.* at 195; RTC Decision.
¹² London Interbank Offered Rate.
¹³ *Supra* note 11.
¹⁴ *Id.*
¹⁵ *Id.* at 195-196.

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 of suit.¹⁷

On 11 December 2000, UCPB Insurance filed its Answer with Special and Affirmative Defenses, Cross-Claim and Compulsory Counterclaim. In its special and affirmative 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 terms 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 condition 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 the

¹⁶ CA *rollo*, p. 75; UCPB Insurance' Brief.

¹⁷ Id. at 74-75.

¹⁸ *Rollo*, p. 196; RTC Decision.

¹⁹ Id. at 197; RTC Decision; *Rollo*, pp. 51-52; CA Decision.

arbitration clause, otherwise, plaintiff's filing the 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 the CA 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 ₱300,000.00, ₱100,000.00, ₱100,000.00 and ₱1,500.00 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

²⁰ CA rollo, pp. 77-78.

²¹ Rollo, pp. 196-197; RTC Decision; CA rollo, pp. 126-127.

²² Id. at 197; id. at 127.

²³ Id.; id.

²⁴ Id. at 198; id. at 128.

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, jointly 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 Cross-Claim against One Virtual Corporation and the Third-Party Complaint against Velarde; attorney's fees of ₱250,000.00; and costs of litigation in the amount of ₱50,000.00.

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 solidarily 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

²⁵ *Rollo*, pp. 204-205; RTC Decision; CA *rollo*, pp. 134-135.

²⁶ CA *rollo*, pp. 29-30.

²⁷ Id. at 84; Appellant's Brief.

²⁸ Id. at 161-188; Appellee's Brief.

²⁹ *Rollo*, pp. 46-61.

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 OVC to pay the balance of the purchase price arises. Further, it ruled that OVC 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;
- 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 OVC 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. DISPUTE RESOLUTION

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

³⁰

Id. at 54-60.



effect at the time of the arbitration. The arbitration shall be in accordance with the following guidelines except to the extent the Parties to arbitration shall agree otherwise:

1. The place of arbitration shall be mutually agreed upon by the Parties.
2. The arbitration panel shall be composed of three arbitrators. Each Party shall appoint one arbitrator. The two arbitrators appointed by the Parties shall attempt to agree on a third arbitrator, who will act as chairman of the panel. If said two arbitrators fail to nominate a third arbitrator within thirty (30) days from the date of appointment of the latter arbitrator, any Party may refer such selection to the ICC.
3. The proceeding shall be conducted and transcribed in English. Any document submitted in a language other than English shall be accompanied by an English translation.
4. All testimony and evidence related to confidential information or trade secrets shall be safeguarded and maintained as confidential, with access to such evidence to be only on a need-to-know basis and subject to all reasonable precautions so as not to jeopardize the confidential information of any Party.
5. The Parties hereby accept jurisdiction of the arbitral tribunal over the Parties over the subject matter of the dispute.

C. Continuation of Performance

During the arbitration, the Parties shall continue to perform their obligations under this Agreement to the extent such performance is not precluded by the subject matter of the dispute.³¹

Based on the cited provision, UCPB Insurance raised the issue of premature filing of complaint without resorting first to the guidelines of dispute resolution.

We grant the petition.

Reading closely, the first sentence of Section A of Title XIII specifically leans towards out of court settlement. It states that:

A. Negotiation

“The Parties shall attempt to resolve any dispute, controversy or difference, which may arise between them through good faith negotiations. xxx.” (Emphasis supplied)

³¹

Id. at 85.

Jurisprudence and statutory construction teach us that the word “shall” connotes mandatory character; it indicates a word of command, and one which has always or which must be given a compulsory meaning, and it is generally imperative or mandatory in nature.³²

On the other hand, “good faith” is defined as an intangible and abstract quality with no technical meaning or statutory definition, and it encompasses, among other things, an honest belief, the absence of malice and the absence of design to defraud or to seek an unconscionable advantage. It implies honesty of intention, and freedom from knowledge of circumstances which ought to put the holder upon inquiry. Furthermore, the essence of good faith lies in an honest belief in the validity of one’s right, ignorance of a superior claim and absence of intention to overreach another.³³

Applying the above parameters, we find that Hughes Electronics failed to exercise good faith in resolving its dispute and differences with OVC over the latter’s complaint for wrongful installation of the contracted system and its subsequent failure to comply with the schedule of payment. Instead, what Hughes Electronics did was to go against UCPB Insurance and demand from the insurance company the remaining monetary obligation instead of exercising good faith negotiation with OVC. Upon unfavorable response to its demand letters, Hughes Electronics immediately filed a court action against UCPB Insurance demanding payment. Hughes Electronics, following the letter of the contract, should have made efforts to settle the dispute with OVC amicably instead of directly resorting to a judicial action.

Another indication of the primacy of the recourse alternative to a court suit is revealed in the second part of Title XIII. It states that, in case of failure of the parties to resolve the dispute amicably, the parties may proceed to arbitration subject to the following exceptions:

xxx “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.” (Emphases supplied)

The CA points out that the stipulation discloses the permissive character of the availment of arbitration proceeding. Also, the word “may,”

³² *Enriquez v. Enriquez*, 505 Phil. 193, 199 (2005).

³³ *Ochoa v. Apeta*, 559 Phil. 650, 655-656 (2007).

as alleged by Hughes Electronics, justified its direct recourse to court without resorting to arbitration. Furthermore, it is contended that the phrase, “*Notwithstanding the above, the Parties may elect to waive applicability of this section,*” is a catch-all clause which means that both negotiation and arbitration may be waived if certain conditions occur. Following this line of reasoning, Hughes Electronics waived the applicability of the arbitration clause and brought the dispute in court based on the second exception that it was suffering irrevocable harm.

We do not agree.

Statutory construction instructs us that the word “may” implies that it is not mandatory but discretionary. It is an auxiliary verb indicating liberty, opportunity, permission and possibility.³⁴ However, while this Court recognizes the statutory principles as efficient tools in understanding the language of contracts, we also take cognizance of the intent of the parties in crafting the stipulations of the contract. This is especially true when one part on dispute resolution provides for a cordial out-of-court settlement couched in mandatory language and the other part implies a permissive referral to arbitration. The fact of the matter is that the waiver of negotiation as the settlement process is through election by both parties in writing. Noting further, there is nothing in the contract which points out a concrete standard to determine irrevocable harm to the other party which would warrant the waiver of arbitration. No proof was adduced in this case that Hughes Electronics will suffer irrevocable harm for the delay. It was an error for the CA to consider that delay necessarily results in irrevocable harm.

It is standing jurisprudence that in interpreting a contract, its provisions should not be read in isolation but in relation to each other and in their entirety so as to render them effective, having in mind the intention of the parties and the purpose to be achieved. The various stipulations of a contract shall be interpreted together, attributing to the doubtful ones that sense which may result from all of them taken jointly.³⁵

This principle aptly applies the provisions on interpretation of contract in the Civil Code. Art. 1370 of the Code states that if the terms of a contract are clear and leave no doubt upon the intention of the contracting parties, the literal meaning of its stipulations shall control. However, it is clearly added that if the words appear to be contrary to the evident intention of the parties, the latter shall prevail over the former. Further on this, Art. 1374 states that the various stipulations of a contract shall be interpreted together, attributing

³⁴ *Demaala v. Commission on Audit*, G.R. No. 199752, February 17, 2015, 750 SCRA 612, 628.

³⁵ *Sps. Juico v. China Banking Corporation*, 708 Phil. 495, 514 (2013); citing *Bangko Sentral ng Pilipinas v. Santamaria*, 443 Phil. 108-119 (2003).

to the doubtful ones that sense which may result from all of them taken jointly.

Apropos is the case of *Adelfa Properties, Inc. v. CA*:³⁶

The important task in contract interpretation is always the ascertainment of the intention of the contracting parties and that task is, of course, to be discharged by looking to the words they used to project that intention in their contract, all the words not just a particular word or two, and words in context not words standing alone. xxx.³⁷

Thus, upon meticulous review of the entire stipulations on dispute resolution in the contract and taking into consideration the intention of the parties, it is necessary that arbitration proceedings be complied before resorting to court action. This is especially true since arbitration is essential in the settlement of commercial disputes involving issues technical in nature such as installation of *burroughs protocol* which can be more appropriately resolved through arbitration where technical knowledge and expertise are the settlement points.

In the case of *Koppel, Inc. v. Makati Rotary Club Foundation, Inc.*,³⁸ we emphasized the autonomy of the parties to stipulate arbitration clause in their contract and the spirit behind its stipulation:

A pivotal feature of arbitration as an alternative mode of dispute resolution is that it is, first and foremost, a product of party autonomy or the freedom of the parties to "make their own arrangements to resolve their own disputes." Arbitration agreements manifest not only the desire of the parties in conflict for an expeditious resolution of their dispute. They also represent, if not more so, the parties' mutual aspiration to achieve such resolution outside of judicial auspices, in a more informal and less antagonistic environment under the terms of their choosing. xxx. (Italics and citation omitted)

To emphasize, in a contract containing a condition precedent, no right or action is given or acquired until such condition is complied with; before the compliance with the condition is accomplished there exists nothing but hope of acquiring such right x x x.³⁹ All in all, this case needs to be referred to arbitration proceedings in accordance with the Rules provided in paragraph B of Title XIII entitled Dispute Resolution of Annex A made part of the Contract between the parties.

³⁶ 310 Phil. 623 (1995).

³⁷ Id. at 639.

³⁸ 717 Phil. 337, 361 (2013)

³⁹ *Barretto v. City of Manila*, G.R. No. 3148, March 5, 1907.

Having thus ruled, we find no need to go into the other assigned errors.

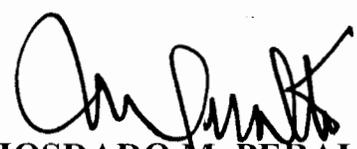
WHEREFORE, the petition is **GRANTED**. Accordingly, the Decision and Resolution of the Court of Appeals, dated 19 March 2009 and 23 November 2009, respectively upholding the 15 March 2007 Decision of the Regional Trial Court of Makati City, are hereby **REVERSED** and **SET ASIDE** and the parties are hereby ordered to refer the case to arbitration in accordance with the International Rules of the International Chamber of Commerce in effect at the time of arbitration and following the guidelines provided by Section B of Title XIII of Annex A made part of the Contract between the parties

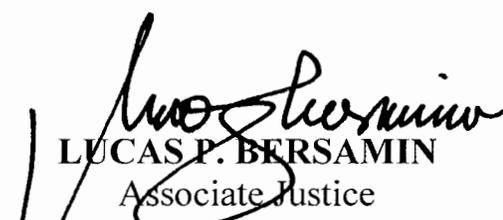
SO ORDERED.


JOSE PORTUGAL PEREZ
Associate Justice

WE CONCUR:

(On Wellness Leave)
PRESBITERO J. VELASCO, JR.
Associate Justice


DIOSDADO M. PERALTA
Associate Justice
Acting Chairperson


LUCAS P. BERSAMIN
Associate Justice


BIENVENIDO L. REYES
Associate Justice

ATTESTATION

I attest that the conclusions in the above Decision had been reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

**DIOSDADO M. PERALTA**

Associate Justice

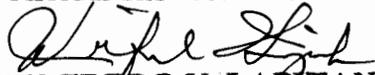
Third Division, Acting Chairperson

CERTIFICATION

Pursuant to Section 13, Article VIII of the Constitution and the Division Chairperson's Attestation, I certify that the conclusions in the above Decision had been reached in consultation before the case was assigned to the writer of the opinion of the Court's Division.

**MARIA LOURDES P. A. SERENO**

Chief Justice

CERTIFIED TRUE COPY**WILFREDO V. LAPIDAN**
Division Clerk of Court
Third Division

DEC 09 2016