

Republic of the Philippines  
**SUPREME COURT**  
Manila

EN BANC

**G.R. No. L-19277**      **January 30, 1967**

**MINDANAO MOTORS CORPORATION**, plaintiff-appellee,

vs.

**BESSIRE HOUSING CORPORATION and CAPITAL INSURANCE & SURETY CO., INC.**, defendants.

**CAPITAL INC. INSURANCE & SURETY CO., INC.**, defendant-appellant.

*Achacoso, Nera & Ocampo for defendant-appellant.*

*Maximo K. Rodriguez and Cecilio P. Luminares for plaintiff-appellee.*

**MAKALINTAL, J.:**

This is an appeal by defendant Capital Insurance & Surety Co., Inc., from the decision of the Court of First Instance of Misamis Oriental ordering it and the other defendant, Bessire Housing Corporation, to pay jointly and severally to plaintiff Mindanao Motors Corporation the sum of P4,274.00 plus 7% interest from March 1, 1952 until fully paid, and 20% of the amount as attorney's fees and costs.

The facts of the case are as follows: Bessire Housing Corporation, hereinafter referred to merely as defendant, had a contract with the Republic of the Philippines to construct for the latter a certain number of pre-fabricated barrio school buildings. In accordance with Act 3688 said defendant, together with the Capital Insurance Surety Co., Inc. hereinafter referred to as appellant, executed a surety bond in favor of "the Government of the Republic of the Philippines and to any individual, firm, partnership, corporation or association supplying the principal with labor, or materials in the penal sum of Thirty Thousand Pesos (P30,000.00)." In consideration of the issuance of the bond and to indemnify the surety company for any and all damages it might incur by reason of the issuance thereof the principal, Bessire Housing Corporation, executed the corresponding indemnity agreement.

During the period from November 8, 1950 to February 11, 1951 defendant engaged and utilized the services of appellee Mindanao Motors Corporation in handling and transporting pre-fabricated building materials. At the same time, appellee supplied defendant with gasoline and performed repairs on the vehicles used in connection with defendant's contract with the Government. On September 5, 1951 appellee and defendant entered into a so-called "agreement" (Exhibit A-7) whereby defendant admitted that as of that date it was indebted to appellee in the sum of P7,201.93 "for all services rendered ... consisting of parts and repairs, oil and gas and hauling." The parties erroneously thought that as of that date the defendant owed appellee only P7,101.39, the additional P100 to serve as interest up to that date. In the

computation of the total debt they had overlooked the amount of P274.00. Actually, therefore, defendant's account with appellee as of that date was in the total sum of P7,375.39. This is reflected in the statement of account, Exhibit A.

In the same agreement appellee acknowledged receipt of P2,202.39. Defendant promised to pay appellee the balance of P5,000.00 (it should be P5,274.00) on or before November 15, 1951, with 7% interest per annum, plus 20% thereof should appellee be forced to go to court for collection. In consideration of the agreement appellee agreed to withdraw the claim it had filed against defendant with the Bureau of Public Works.

On March 12, 1952 defendant paid P1,000.00 on the principal and P184.00 as interest up to that date. Thereafter appellee made demands both upon defendant and upon appellant surety company for the balance of P4,274.00, and when they failed to pay, appellee commenced the present action.

Both defendants below moved to dismiss on the ground that appellee had no cause of action against them because of its failure to comply with the requirements of Act No. 3688. After the court denied the motions, defendants filed their respective answers. The answer of the surety company included a cross-claim against its co-defendant for reimbursement of whatever amount it might be adjudged to pay the plaintiff. After trial the court handed down the decision appealed from. On the cross-claim, defendant Bessire Housing Corporation was ordered to reimburse the surety company whatever amount it might have to pay plaintiff, plus 15% thereof as attorney's fees, and the sum of P435.60 for other items specifically mentioned.

Appellant contends that the lower court erred: (1) in denying its motion to dismiss the complaint for failure to state a cause of action; (2) in not finding that the agreement Exhibit A-7 between appellee and defendant resulted in the extinctive novation of the obligation under the surety bond; and (3) in holding appellant liable to appellee for attorney's fees in the amount of 20% of the amount due.

The bond sued upon (Exhibit C) was executed in compliance with Act 3688, section 1 of which provides as follows:

Any person, partnership or corporation, entering into a formal contract with the Government of the Philippine Islands for the construction of any public building, or the prosecution and completion of any public work, or for repairs upon any public building or public work, shall be required, before commencing such work, to execute the usual penal bond, with good and sufficient sureties, with the additional obligation that such contractor or his or its sub-contractors shall promptly make payments to all persons supplying him or them with labor and materials in the prosecution of the work provided for in such contract; and any person, company or corporation who has furnished labor or materials used in the construction or repair of any public building or public work, and payment for which has not been made, shall have the right to intervene and be made a party to any action instituted by the Government of the Philippine Islands on the bond

of the contractor, and to have their rights and claims adjudicated in such action and judgment rendered thereon, subject, however, to the priority of the claim and judgment of the Government of the Philippine Islands. If the full amount of the liability of the surety on said bond is insufficient to pay the full amount of said claims and demands, then, after paying the full amount due the Government, the remainder shall be distributed pro rata among said intervenors. If no suit should be brought by the Government of the Philippine Islands within six months from the completion and final settlement of said contract, or if the Government expressly waives its right to institute action on the penal bond, then the person or persons supplying the contractor with labor and materials shall, upon application therefor, and furnishing affidavit to the department under the direction of which said work has been prosecuted, that labor or materials for the prosecution of such work have been supplied by him or them, and payment for which has not been made, be furnished with a certified copy of said contract and bond, upon which he or they shall have a right of action, and shall be, and are hereby, authorized to bring suit in the name of the Government of the Philippine Islands in the Court of First Instance in the district in which said contract was to be performed and executed, and not else where, for his or their use and benefit, against said contractor and his sureties, and to prosecute the same to final judgment and execution: *Provided*, That where suit is instituted by any of such creditors on the bond of the contractor and final settlement thereof, and shall be commenced within one year after the performance and final settlement thereof, and not later: *Provided, further*, That where suit is so instituted by a creditor or by creditors, only one action shall be brought, and any creditor may file his claim in such action and be made party thereto within one year from the completion of the work under said contract and final settlement thereof, and not later. If the recovery on the bond should be inadequate to pay the amounts found due to all of said creditors, judgment shall be given to each creditor pro rata of the amount of the recovery. The surety on said bond may pay into court, for distribution among said claimants and creditors, the full amount of the sureties' liability, to wit, the penalty named in the bond, less any amount which said surety may have had to pay to the Government by reason of the execution of said bond, and upon so doing the surety will be relieved from further liability: *And Provided, further*, That in all suits instituted under the provisions of this section personal notice of the pendency of such suits, informing them of their right to intervene as the court may order, shall be given to all known creditors, and in addition thereto notice by publication in some newspaper of general circulation, published in the province or town where the contract is being performed, for at least three successive weeks, the last publication to be at least three months before the time limited therefor.

The evident purpose of the bond required under the legal provision just quoted is to protect both the Government and those who supply the contractor with labor and/or materials, although claims of the Government enjoy preference over claims of the suppliers (Government of the Philippine Islands vs. Visayan Surety and Insurance Corporation, 66 Phil. 326).

Either the Government or a supplier of labor or materials may file suit on the bond. If the Government should choose to do so, any of the suppliers may intervene. Should a supplier wish to initiate the suit himself, several conditions must be present: (1) that no suit has been brought by the Government within six months from the completion and final settlement of the contract or that the Government has expressly waived its right to institute action on the bond; (2) that the suit by the supplier is commenced after, and within one year from, performance and complete settlement of the contract; (3) that only one suit may be brought by any and all creditors whose claims may be filed in said suit during the one-year period prescribed; and (4) that personal notice of the pendency of the suit, informing them of their right to intervene, shall be given to all creditors, and there shall be notice by publication in some newspaper of general circulation published in the province or town where the contract is being performed.

The law, it may be noted, requires that before an action may be filed on the bond the principal contract with the Government must have been completed and settled. This requirement is necessary so that all those who have furnished labor and materials to the contractor may have equal chances to file their respective claims for payment. If an early supplier of labor and materials were allowed to file suit even before the work is completed, he would have a distinct advantage over later suppliers, whose claims might not be satisfied in full if the bond should prove insufficient. Such a procedure would render ineffective the provision that "if the recovery on the bond should be inadequate to pay the amounts found due to all of said creditors, judgment shall be given to each creditor *pro rata* of the amount of the recovery."

Appellee calls attention to the allegation in the complaint that "plaintiff is hereby given authority by the Government of the Republic of the Philippines to sue Bessire Housing Corporation for the recovery of the amount of P4,274.00 plus 7% interest annually from March 1, 1952 until fully paid conformably with Act No. 3688 and likewise furnished a certified copy of the contract and of the Security Bond executed by the said Bessire Housing Corporation jointly and severally with the Capital Insurance & Surety Co., Inc., which formed as basis of our filing complaint against both defendants." From this, however, it cannot be determined just when the contract with the Government was settled and terminated. The record shows that the Secretary of Public Works signed the waiver on January 31, 1955. But this waiver does not in any way prove that the suit was commenced within the time prescribed by the statute, that is, after completion of the contract with the government and within one year thereof.

Since appellee was suing on the bond, all the conditions prescribed by the statute in order that liability under such bond may arise should be alleged. The record, however, is bereft of any allegation or evidence to show the fact and the date of "performance and final settlement" of the contract with the Government. Before such performance and settlement, any suit on the bond was premature.

Our law on contractor's penal bond appears to have been patterned after the former American law on the matter (40 U.S. C.A. No. 270a), with the only difference that the latter does not require a waiver by the Government within six months of "performance and settlement."

Interpreting that provision, the Circuit Court of Appeals (Eighth Circuit) said in *Salyers vs. U.S., for Use of Indiana Quarries Co.*, 257 F. 255, that "the bond required by the statute ... performs a double function: first, to secure to the government a faithful performance on the part of the contractor; secondly, to protect persons from whom the contractor obtains labor and materials;" but that "while the statute creates a new cause of action, it does so upon the terms named in the statute." Hence:

The right of action given to creditors is specifically conditioned upon the fact that no suit shall be brought by the United States within six months named, for it is only in that event that the creditors shall have a right of action and may bring a suit in the manner provided. The statute thus creates a new liability and gives a special remedy for it, and upon *well-settled principles the limitations upon such liability become a part of the right conferred and compliance with them is made essential to the assertion and benefit of the liability itself.* (Emphasis supplied.)

From this it is clear that a creditor's right to recover on the bond is subject to the condition that the Government has not filed suit within six months of "performance and final settlement," although under our law, Act 3688, an alternative condition is provided for, namely, that the Government expressly waives its right to sue.

At the same time, the law contemplates only one suit in which all creditors should file their claims. It does not matter if the claim of the creditor who initiates the suit is unmeritorious, as long as the suit is instituted within the required period and after complying with the required formalities. Subsequent separate suits on the bond will have to be dismissed.

The statute, of course, provides that under such circumstances only one suit may be brought, and it is well settled that if a second suit is begun it is a mere nullity and must be treated as such.

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The statute provides that when one such suit is brought the field is occupied and all other creditors having similar claims must come in by intervention and cannot bring a separate suit. It might sometimes very well be that the first or principal suit could not be sustained on its merits. The statute does not make the successful issue of the first suit a condition of intervention. If the suit is properly brought on the contract and bond, it is rightfully in court, and the pertinent allegations are adopted by the several intervenors as if separately set forth by them. It is not the merit of the first suit that is important. It is the allegations. The intervenors ordinarily have no way of knowing whether the first suit is well-founded or not. It is the bond they are interested in, and they have no concern with the merits except as the amount to be distributed among the claimants. (*United States, to Use and Benefit of Sargent Co. vs. Century Indemnity Co.*, 9 F. Supp. 809.)

If a materialman should be allowed to sue before "performance and final settlement" of the contract, then those who subsequently furnish the contractor with labor and materials would not be able to file their own claims or share in the fund set up by the contractor's bond. They could not file their claims in the first suit because their accounts with the contractor have not been settled. And any separate action filed thereafter would not be entertained.

But even assuming that the action here was filed within the prescribed period, it should have been dismissed just the same with respect to appellant, because it does not appear that the requirement of notice by publication in the newspapers had been complied with. The American rule was stated in U.S., to Use of *Van Chief v. Merrick* 215 F. 256:

As to whether an action can be maintained by a single creditor, who starts his suit within the year, but who does not comply with the sections as to publication and personal service, presents a different proposition. It has been held in the case of *United States ex rel. Joseph Sario vs. Eldrige Const. Co., et al.*, decided in this district upon October 21, 1913, and affirmed by the Circuit Court of Appeals on April 22, 1914 (*Merchant's Nat. Bank vs. United States ex rel. Sario* 214 Fed. 200, 130 C.C.A. 548), that the requirements of bringing suit within a year of filing claims within the year, and of complying with the statute so as to bring in all creditors, are jurisdictional. Compliance with the provision as to "known creditors" was held negligible, if none were "known"; but the provisions as to advertising was declared to be mandatory and jurisdictional, citing *United States vs. Standard* (D.C.), 206 Fed. 326.

The jurisdictional character of the publication of notice has been affirmed, albeit inferentially, in the case of *Government v. Visayan Surety & Insurance Corporation, supra*, where this Court said:

This court is of the opinion that once the jurisdiction of the court is acquired by the publication of the ordered October 23, 1934, any extension of the period, provided it be within the same period of one year fixed by law for presentation of the claims, is no longer jurisdictional.

Because of the foregoing consideration, we find it unnecessary to take up the other points raised by appellant, and hold that the lower court erred in denying appellant's motion to dismiss on the ground of failure to state a cause of action.

The judgment appealed from is reversed, and the complaint is dismissed as against appellant, with costs.

*Concepcion, C.J., Reyes, J.B.L., Dizon, Regala, Bengzon, J.P., Zaldivar, Sanchez and Castro, JJ., concur.*