Prepayment of Premium as a Condition to the Validity of an Insurance Contract

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I. Introduction

The insurance system provides immeasurable service primarily by providing security to the public. Through a mutual agreement, a pool of funds is created to help service the contingent needs of every member or policy holder. In order to provide this service, an insurance company must maintain a reserve fund to meet its contingent obligations. This fund is sourced from *premium payments.*

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An insurance premium is an agreed price in consideration for the insurer's undertaking to indemnify the insured against a specified peril. Premium, therefore, "is the *elixir vitae* of the insurance business."[1] Hence, there is the need for its prompt and full payment. Lately, however, there has been a resurgence of the *credit term* facility granted to the insured which falls short of meeting the need for a full and prompt payment of the premium.

This Article will deal primarily with the question: Is an agreement granting a credit term within which to pay the premium valid notwithstanding the express prohibition in Section 77 of the Insurance Code of 1978?[2]

On April 4, 2001, the Supreme Court *en banc* replied in the affirmative when it issued a decision reversing the resolution rendered barely two years previously by its First Division.[3] This latest resolution has apparently bothered the insurance industry no end. It has even intervened through the Insurance and Surety Association of the Philippines Incorporated (ISAP), an organization representing 114 non-life insurance companies doing business in the Philippines.[4] The reversal of the decision of the Supreme Court's First Division by no less than the Supreme Court *en banc* has initially caused some ripples of disbelief among some law professors of insurance, who, like the ISAP, are aware of the historical antecedents behind the insertion of the phrase *"notwithstanding any agreement to the contrary"* in Section 77 of the Insurance Code.

To properly appreciate this latest decision of the Highest Court, it would be appropriate: (1) to review the facts in this case; and, (2) to examine the said controversial provision of the law and its historical antecedents.

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1. Tibay v. Court of Appeals, 257 SCRA 126, 141 (1996).

2. A Decree to Consolidate and Codify all the Insurance Laws of the Philippines [INSURANCE CODE] Presidential Decree No. 1460 (1978).

3. United Coconut Planters Bank (UCPB) General Insurance Co., Inc. v. Masagana Telamart Inc., 356 SCRA 307 (2001). In this case the Supreme Court reversed the earlier case of UCPB General Insurance Co., Inc. v. Masagana Telamart Inc., 308 SCRA 259 (1999).

4. *Id.* ISAP, Inc. moved for intervention in June, 2001.

II. THE FACTS OF THE CASE

A. Procedural History

UCPB General Insurance Co., Inc. v. Masagana Telamart Inc.[5] is a resolution of a motion for reconsideration filed by Masagana Telamart, Inc. pursuant to the Supreme Court's decision in an earlier case of the same name. In the earlier case, the Court reversed the decision of the Court of Appeals, which affirmed that of the trial court and held against UCPB General Insurance.

Masagana procured from UCPB five fire insurance policies on its properties in Pasay City and Manila. The effectivity term of each was from May 22, 1991 to May 22, 1992. On June 13, 1992, two of Masagana's properties along Taft Avenue were razed by fire. On July 13, 1992 Masagana tendered five Equitable Bank Manager's Checks to UCPB as renewal premium payments, for which UCPB issued official receipts. The next day, Masagana made a formal demand on UCPB for indemnification. UCPB, however, rejected the demand on the grounds that, among other things, the policies had expired and had not been renewed and that the properties were burned before tender of premium payment. Thus, Masagana was forced to file a case for collection of its indemnification against UCPB.

Both the appellate and trial courts decided against UCPB. They found that UCPB failed to notify the insured of its intention not to renew the policies at least forty-five days before their expiration, thereby giving Masagana automatic renewal upon payment of premiums.[6] Furthermore, it

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5. *UPCB,* 356 SCRA at 318.

6. Pursuant to Condition No. 26 of the policies, which is an exact reproduction of § 66 of the Insurance Code which provides:

> Sec. 66. In case of insurance other than life, unless the insurer at least forty-five days in advance of the end of the policy period mails or delivers to the named insured at the address shown in the policy notice of its intention not to renew the policy or to condition its renewal upon reduction of limits or elimination of coverages, the named insured shall be entitled to renew the policy upon payment of the premium due on the effective date of the renewal. Any policy written for a term of less than one year shall be considered as if written for a term of one year. Any policy written for a term longer than one year or any policy with no fixed expiration date shall be considered as if written for successive policy periods or terms of one year.

was proven that such payments, though late, were made pursuant to a 60- to 90-day credit term which UCPB had been accustomed to give Masagana. Indeed, according to the Court of Appeals, the fact that UCPB accepted the premiums on July 13, 1992, or more than a month from due date of the premiums, indubitably indicated a willingness on its part to assume the risk.

B. Initial Supreme Court Decision

The Supreme Court initially debunked the arguments of both the trial and appellate courts in view of Section 77 of the Insurance Code and previous decisions which held that "an insurance policy, other than life, issued originally or on renewal, is not valid and binding until actual payment of the premium. Any agreement to the contrary is void."[7] Furthermore, the Court in *Valenzuela v. Court of Appeals*[8] ruled that non-payment of premiums results in the lapse and forfeiture of the policies.[9]

Not satisfied, Masagana filed a motion for reconsideration, alleging that the Supreme Court made its own findings of fact contrary to that of the Court of Appeals, and consequently, the argument of the Court of Appeals that the policy was renewed by operation of law and by payment of the premiums within the credit term should be upheld. It also asserted that extending credit terms was a prevalent practice in the insurance industry and that Section 77 should not be read as being prohibitive of credit agreements but merely consisting of protection for the parties to an insurance contract. Finally, Masagana asserted that UCPB should be held to be in estoppel as it induced the former to believe that payment pursuant to the credit term was perfectly acceptable.

A reading of Section 66 of the Insurance Code readily shows that in order for an insured to be entitled to a renewal of a non-life policy, payment of the premium due on the effective date of renewal should first be made.

7. *UCPB*, 356 SCRA at 263, *citing* Valenzuela v. Court of Appeals, 191 SCRA 1, 15 (1990); South Sea Surety and Insurance Co., Inc. v. Court of Appeals, 244 SCRA 744, 747 (1995); and Tibay v. Court of Appeals, 257 SCRA 126, 141 (1996).

8. Valenzuela v. Court of Appeals, 191 SCRA 1 (1990).

9. *Id.* at 15.

C. Reversal of the Initial Supreme Court Decision

The Supreme Court consequently reversed its previous decision and construed credit arrangements as an additional exception to Section 77. This holding was based mainly on an *obiter* in *Makati Tuscany Condominium Corporation vs. Court of Appeals*,[10] which held that the parties to an insurance contract were free to allow credit arrangements.[11] The Court allowed the credit term therein based on the principle of autonomy of contracts found in Art. 1306 of the Civil Code.[12] Allowance of the credit term was also based on a finding of estoppel on the part of UCPB.

This Article will thus deal with the propriety of the Court's actions in the instant case. More specifically, it will discuss the acceptability of construing credit arrangements as an exception to Section 77, despite the seemingly restrictive language of both the law and the deliberations leading up to its enactment.

III. LEGAL HISTORY

The controversial Section 77 of the Insurance Code provides for a *proviso* voiding any agreement contrary to the general rule of payment of premium as soon as the thing insured is exposed to the peril insured against. The said provision states that:

> An insurer is entitled to payment of the premium as soon as the thing insured is exposed to the peril insured against. *Notwithstanding any agreement to the contrary,* no policy or contract of insurance issued by an insurance company is valid and binding unless and until the premium thereof has been paid, except in the case of a life or an industrial life policy whenever the grace period provision applies.[13]

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10. Makati Tuscany Condominium Corporation v. Court of Appeals, 215 SCRA 462 (1992).

11. *Id.* at 468.

12. An Act to Ordain and Institute the Civil Code of the Philippines [CIVIL CODE OF THE PHILIPPINES] art. 1306:

    > The contracting parties may establish such stipulations, clauses, terms and conditions as they may deem convenient, provided they are not contrary to law, morals, good customs, public order, or public policy.

13. INSURANCE CODE, § 77 (emphasis supplied).

A. Statutory Antecedents of Section 77

The latest UCPB case itself provides a brief history of Section 77. Thus, the Supreme Court said:

> This Section is a reproduction of Section 77 of P.D. No. 612 (The Insurance Code) promulgated on 18 December 1974. In turn, this Section has its source in Section 72 of Act. No. 2427 otherwise known as the Insurance Act, as amended by R.A. No. 3540, approved on 21 June 1963, which read:
>
> Sec. 72. An insurer is entitled to payment of premium as soon as the thing insured is exposed to the peril insured against, *unless there is clear agreement to grant the insured credit extension of the premium due.* No policy issued by an insurance company is valid and binding unless and until the premium thereof has been paid.[14]

The Supreme Court itself admitted that the italicized portion of Section 72 of the Insurance Act has not been restated in Section 77 when it said: "It can be seen at once that Section 77 does not restate the portion of Section 72 expressly permitting an agreement to extend the period to pay the premium. But are there exceptions to Section 77? The answer is in the affirmative."[15]

B. Jurisprudential Exceptions to the Payment of Premiums as Preconditions

The Supreme Court then proceeded to enumerate five exceptions to the payment of premiums as a precondition to the validity of an insurance contract.

The first two are exceptions provided by law. First, Section 77 itself excepts "the case of a life or an industrial life policy whenever the grace period provision applies." The second is found in Section 78 which states:

> Any acknowledgment in a policy or contract of insurance of the receipt of premium is conclusive evidence of its payment, so far as to make the policy binding, notwithstanding any stipulation therein that it shall not be binding until premium is actually paid.

The Supreme Court, discussing the third exception, stated thus:

> A third exception was laid down in *Makati Tuscany Condominium Corporation v. Court of Appeals,* wherein we ruled that Section 77 may not

14. *UCPB,* 356 SCRA at 316 (emphasis supplied).

15. *Id.*

> apply if the parties have agreed to the payment in installments of the premium and partial payment has been made at the time of loss.[16]

This exception is not controversial considering the facts of the case. The premiums were actually paid but the parties initially agreed to pay them in installments – which practice was continued throughout two renewals of the same contract.[17]

The fourth and fifth exceptions, however, are not as easily acceptable. The fourth exception – the granting of a credit extension – is the subject of this Article. The fifth exception, estoppel, may well be the subject of another study.[18]

An examination of the fourth exception is essential. These are the words of the Supreme Court regarding the fourth exception:

> By the approval of the aforequoted findings and conclusion of the Court of Appeals, *Tuscany* has provided a fourth exception to Section 77, namely, that the insurer may grant credit extension for the payment of the premium. This simply means that if the insurer has granted the insured a credit term for the payment of the premium and loss occurs before the expiration of the term, recovery on the policy should be allowed even though the premium is paid after the loss but within the credit term.
>
> Moreover, there is nothing in Section 77 which prohibits the parties in an insurance contract to provide a credit term within which to pay the premiums. That agreement is not against the law, morals, good customs, public order or public policy. The agreement binds the parties. Article 1306 of the Civil Code provides:

16. *UCPB*, 356 SCRA at 317.

17. It may be interesting to note that the *Makati Tuscany* case was not a demand by the insured for the payment of a fire loss, but was a demand for the refund of previous years' premium payments as well as the refund of current installment payments on the ground that the fire policies involved were void because the premium was not paid in full at the beginning of the policy term.

18. There are, of course, other exceptions – though the *UCPB* case failed to mention them. The first are cover notes, where the premium of the policy cannot, as of yet, be determined with certainty. *See* INSURANCE CODE, § 52. *See also* Pacific Timber Export Corp. v. Court of Appeals, 112 SCRA 199, 205 (1982)). The second exception is a surety contract wherein the obligee has accepted the bond (INSURANCE CODE, § 177.

> Art. 1306. The contracting parties may establish such stipulations, clauses, terms and conditions as they may deem convenient, provided they are not contrary to law, morals, good customs, public order, or public policy.[19]

When the Supreme Court said that "there is nothing in Section 77 which prohibits the parties in an insurance contract to provide a credit term within which to pay the premiums"[20] and that said agreement is "not against the law, morals, good customs, public order or public policy,"[21] what then are the agreements referred to in the clause, "*notwithstanding any agreement to the contrary,* no policy or contract of insurance issued by an insurance company is valid and binding unless and until the premium thereof has been paid" found in §77?

The crux of the controversy therefore must begin with a determination of whether or not the phrase "notwithstanding any agreement to the contrary" precludes exactly the type of credit arrangement that UCPB granted to Masagana. In this respect, it would be wise to ask the following questions:

Is not a credit agreement "an agreement to the contrary?"

Is not the credit agreement itself contrary to law, namely Section 77 of the Insurance Code?

IV. The Ratio of the Supreme Court

As will be seen in subsequent analyses, the deliberations involving said article expressly state that credit arrangements *do not constitute an exception to the rule.* Yet, legislative and administrative deliberations regarding statutes place a distant second in the rules of interpretation to judicial construction. That is why it is imperative, at least at the outset, to fully discuss the Court's rationale in excepting credit arrangements from Section 77.

The instant case is not the first time that credit arrangements vis-à-vis insurance contracts have been tackled by the judiciary. In the aforementioned *Makati Tuscany* case, the Court had occasion to ponder the effects of such a credit term on the effectivity of insurance policies and the validity of *late* premium payments. In that case, the insurer, American Home Assurance, entered into a contract of insurance with Makati Tuscany

19. *UCPB*, 356 SCRA at 318.

20. *Id.*

21. *Id.*

Condominium Corporation with a provision for payment of the premiums by installment. After successive renewals, Makati Tuscany discontinued paying further installments and filed an action to recover the premiums it had already paid – on the contention that payment by installment violated Section 77 and thus the contracts were not valid and binding.

In upholding the validity of the contracts, the Supreme Court held that since Makati Tuscany had previously paid and since American Home Assurance had likewise accepted the payments by installment, it was clear that both parties intended to make the contracts valid, effective and binding. It would thus be inequitable for the insured to suddenly renege on its obligation to complete payment of the premiums.

In fact, had the Supreme Court left its disquisition at that, the UCPB case might have been decided quite differently. Unfortunately, it went on to quote with approval the decision of the Court of Appeals:

> While the import of Section 77 is that prepayment of premiums is strictly required as a condition to the validity of the contract, We are not prepared to rule that the request to make *installment payments* duly approved by the insurer, would prevent the entire contract of insurance from going into effect despite payment and acceptance of the initial premium or first installment. Section 78 of the Insurance Code in effect allows waiver by the insurer of the condition of prepayment by making an acknowledgment in the insurance policy of receipt of premium as conclusive evidence of payment so far as to make the policy binding despite the fact that premium is actually unpaid. Section 77 merely precludes the parties from stipulating that the policy is valid even if premiums are not paid, but does not expressly prohibit an agreement granting *credit extension*, and such an agreement is not contrary to morals, good customs, public order or public policy (De Leon, the Insurance Code, at p. 175). So is an understanding to allow the insured to pay premiums in installments not so proscribed. At the very least, both parties should be deemed in estoppel to question the arrangement they have voluntarily accepted.[22]

It was precisely this quote that served as a primary basis for the Court's validation of the credit agreement in the instant case.

Was it not, therefore, somewhat remiss of the Court of Appeals, in deciding *Makati Tuscany*, to make a blind logical leap from installment payments to credit arrangements? And was it not similarly erroneous for the Supreme Court in both *Makati Tuscany* and the instant case to take such

22. *Id.* at 317-318 (emphasis supplied).

statement at its face value without elaborating on the inherent difference between the credit extension and the installment payments granted in the policies?

Though both are similar in some respects, the nature of the installment payments in *Makati Tuscany* is markedly different from the credit term under which Masagana paid its premiums. In the former, the payment scheme allowed Makati Tuscany to pay its premiums in either four or five installments. This, of course, led to the Court's holding that upon the third renewal of the contract, partial payment of two installments concluded a valid policy between the parties. In the instant case, however, what was agreed upon by the parties, albeit impliedly, was a period of time past the due date of the premiums within which payment could still be effected; and such payment, once made, was the last one required of Masagana.

Besides, the credit extension in the instant case was in regard to payment of the first, and only, premium. In *Makati Tuscany*, at the time of discontinuance of payment, two installments had already been paid. Following the doctrine in *Philippine Phoenix Surety & Insurance Co., Inc. v. Woodworks, Inc.*,[23] non-payment of the *balance* of the premium does not produce the cancellation of the contract.[24] This ruling covers *Makati Tuscany*. The instant case, however, is more akin to the doctrine in the other *Philippine Phoenix* case,[25] which held that if no premiums have ever been paid, there is no contract of insurance.[26] To therefore apply such statement piecemeal to the instant case bespeaks a careless disregard of the necessity of concurring factual antecedents. At the very least, what the Court did in this case is to elevate a mere *obiter dictum* to not only the status of a *ratio decidendi* with far-reaching implications, but indeed, to a very exception to the plain import of the black letter law, as found in Section 77.

A closer reading of the aforementioned Court of Appeals decision shows that any inherent differences between installment payments and credit extensions were disregarded on the sole contention that contracts are generally autonomous. Effectively, what was being said was that payment schemes, whether by installment or via extensions, are exactly those

23. Philippine Phoenix Surety & Insurance Co., Inc. v. Woodworks, Inc., 20 SCRA 1270 (1967).

24. *Id.* at 1273.

25. Phil. Phoenix Surety & Insurance Co., Inc. v. Woodworks, Inc, 92 SCRA 419 (1979).

26. *Id.* at 424.

"stipulations, clauses, terms and conditions" which the contracting parties may establish as they deem convenient – the only limitation being that they are not contrary to law, morals, good customs, public order and public policy.[27] This was confirmed by the Court in the instant case when it said, "there is nothing in Section 77 which prohibits the parties in an insurance contract to provide a credit term within which to pay the premiums. That agreement is not against the law, morals, good customs, public order or public policy. The agreement binds the parties."

Credit extensions are clearly not contrary to morals, good customs, public order or public policy. But, are they similarly free from the taint of unlawfulness? The Court seemed to think so, relying on the conclusion that "Section 77 merely precludes the parties from stipulating that the policy is valid even if premiums are not paid, but does not expressly prohibit an agreement granting credit extension."[28]

With this in mind, it is thus necessary to make an inquiry into Section 77 itself, and consequently, into the phrase "notwithstanding any agreement to the contrary."

V. ANALYSIS

A. Determining the Legislative Intent on the Omission of Credit Agreements in Section 77

The history of the enactment of the present Insurance Code may provide us an insight into the controversy surrounding Section 77. The Insurance Code of 1978 is a recodification of the first Insurance Code promulgated in 1974, including therein all subsequent amendments.[29] These were promulgated as Presidential Decrees during the time of President Ferdinand E. Marcos, in the exercise of his legislative powers under martial law. We are therefore handicapped by the lack of legislative journals, as we commonly know them, which are available for perusal once a law is passed by the two Houses of Congress. Nevertheless, the legislative intent as evidenced by legislative journals can be gathered from the proceedings which discussed the 1978 law when it was introduced to the public in 1975 by the University of the

27. CIVIL CODE OF THE PHILIPPINES, art. 1306.

28. UCPB General Insurance Co., Inc. v. Masagana Telemart, Inc., 356 SCRA 307, 318 (2001).

29. The Insurance Code, Presidential Decree No. 612, as amended (1974).

Philippines (U.P.) Law Center, in collaboration with the Insurance Commission and the Philippine Insurance Institute.

When the First Institute on Insurance in 1975 was conducted by the U.P. Law Center to discuss the new Insurance Code, then Insurance Commissioner Gregoria Cruz-Arnaldo said, among other things, in her opening remarks:

> In drafting the Insurance Code, the Insurance Commission tried to cover all conceivable areas where regulation is felt to be necessary without, however, stultifying the growth of the Philippine insurance industry. Believing that law is a living science and should be interpreted in the light of contemporary events, the Insurance Commission tried to draft an Insurance Code which is flexible enough to grow with the growth of the industry. Care was taken to avoid drafting a Code which might be obsolete after twenty years or so.
>
> Let me mention briefly some of the salient provisions of the Insurance Code:
>
> x x x
>
> 6. No policy or contract of insurance issued by an insurance company shall be valid unless the premium therefore has been paid.
>
> x x x
>
> The Insurance Code is a joint effort of government and the insurance industry. While it is true that the first draft was prepared by our [o]ffice, a rigorous public hearing was held and suggestions and recommendations of the industry were adopted whenever feasible. The Code was signed by the President on December 18, 1974.[30]

A significant statement of then Insurance Commissioner Arnaldo is that the Insurance Code was a joint effort of government and the insurance industry. The first draft was prepared by the Office of the Insurance Commissioner, and suggestions and recommendations of the industry were adopted, whenever feasible, after a rigorous public hearing. In fact, one of the participants in the open forum, much later in the proceedings introducing the new Insurance Code, remarked of having distinctly remembered "that

30. Gregoria Cruz-Arnaldo, Opening Remarks by the Insurance Commissioner, AN INTRODUCTION TO THE NEW INSURANCE CODE (PROCEEDINGS OF THE FIRST INSTITUTE ON INSURANCE) 1-2 (1975).

the New Insurance Code is composed of 90% suggestions from the insurance industry and 10% from the insurance commissioner."[31]

Effectively therefore, the Insurance Code of 1978, including Section 77, was a joint effort between players in the insurance industry and the government. What this implies is that Section 77 was enacted, as such, in order to forestall possible loopholes and abuses then existing in the insurance business. As will be seen below, the granting of credit extensions is one such loophole that was deliberately addressed, and supposedly foreclosed, by Section 77.

In an article in the Finance Journal, a monthly publication of the Department of Finance, which supervises the Insurance Commission, entitled *Salient Features of the Insurance Code – Presidential Decree No. 612,* particularly the Section on provisions aimed at further protecting the interests of the policyholders, states that:

> *No policy or contract of insurance issued by an insurance company should be valid unless the premium therefore has been paid.* – In other words, there shall no longer be any extension of credit with respect to insurance premiums. It seems that most of the cases of misappropriation of premium collections committed by insurance agents arise from the fact that the agent is usually given the opportunity to hold the premium collections during the period covered by the credit extension.[32]

No clearer case for the invalidity of credit agreements can be put forward than through this statement. Many non-life insurance agents had the pernicious practice of delaying the remittance of their premium collections until the end of the credit term granted. Some unscrupulous agents even deliberately withheld their collections, hoping that the peril insured against would not happen during the term of the policy. If it did, they would always have the credit term to fall back on. If it did not, then, in the extreme, the agent would keep his collection without the knowledge of either the insured or insurer until an insured would complain that he had not received his official receipt or an alert auditor discovered the misappropriation. But this generally happens usually months, or even years later. As a result, at the time of the drafting of the Insurance Code, the non-life insurance industry wanted the practice of credit agreements discontinued and lobbied for an

31. *Id.* at 124.

32. 3 FINANCE JOURNAL 13 (No. 13, Jan. 1975).

appropriate provision in the Insurance Code to ban its use. This resulted in Section 77, as it is now worded.[33]

In his talk about the salient features of the New Insurance Code, Eduardo Malinis,[34] spoke on the topic of Administrative Settlement of Insurance Claims and Salient Features of the Insurance Code. He said:

> [N]o policy or contract of insurance issued by an insurance company shall be valid unless the premium therefore has been paid. An acknowledgment in the policy of the receipt of the premium shall be conclusive evidence as to its payment. An insurance company that delivers a policy to its agent or to a broker shall be deemed to have authorized such agent or broker to receive in its behalf payment of the premium therefore.
>
> In other words, there shall no longer be any extension of credit with respect to insurance premiums. It seems that most of the cases of misappropriation of premium collections committed by insurance agents arise from the fact that the agent is usually given the opportunity to hold the premium collections during the period covered by the credit extension.[35]

In the subsequent open forum, the practice among insurance companies of extending to policyholders the credit agreement period of thirty, sixty or ninety days.[36] A question was asked thereafter as to the effect of the provisions of Section 77 on these extensions of a credit agreement period to policyholders.[37] Mr. Malinis answered, "We do not have credit extension(s) any more in the light of the provisions of the Insurance Code."[38] When asked whether it would still be allowable, Mr. Malinis answered, "The law is very clear that it is not."[39]

Mr. Heminio Villamayor,[40] who spoke on Casualty Insurance in the same proceedings, said on the same Section 77:

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33. Interview with Mr. Ernesto F. Martinez, former President of Insular General Insurance Co., Inc. and of Malayan Reinsurance Co., Inc.

34. Chief, Public Assistance and Claims Adjudication Division, Insurance Commission, who later became Insurance Commissioner.

35. AN INTRODUCTION TO THE NEW INSURANCE CODE, *supra* note 30, at 242.

36. *Id.* at 266.

37. *Id.*

38. *Id.* at 266-267.

39. *Id.*

40. Vice President of Filipino Merchants Insurance Co., Inc.

> What are the implications of this provision of Section 77? Under Section 72 of the old law, a policy is valid even if the premium is not paid provided there is a credit agreement attached to the policy. Under Section 77, "notwithstanding any agreement to the contrary," no policy is valid unless the premium is paid. Does this mean an insurance policy is now on a "cash and carry" basis? This seems to be the intention of the law.[41]

Mr. Y.H. Uy[42] and Atty. Lope E. Adriano,[43] both acknowledged authorities on fire insurance, also expounded on Section 77 in the same proceedings, when they spoke on Fire Insurance.

Mr. Y.H. Uy discussed the history of the provisions concerning premium payments, which serve as the background of Section 77, as follows:

> In the year 1963, Republic Act No. 3540 was enacted to amend Section 72 of the defunct Insurance Act to the effect that unless there is [a] clear agreement to grant the insured credit extension of the premium due, no policy is valid and binding until the premium is paid.
>
> Immediately it was pointed out then that there was contradiction with the provisions of Section 60 of the same Act which provides that an acknowledgment in a policy of the receipt of premium is conclusive evidence of its payment, so far as to make the policy binding, notwithstanding any stipulation therein that it shall not be binding until the premium is actually paid.
>
> This school of thought believed then that since Section 72 was enacted later, it should prevail over Section 60. Another school of thought, however, was of the opinion that it should be so only if the earlier law is repugnant or inconsistent with the new law. They believed that the two sections actually complement rather than contradict each other.
>
> In order to avoid any future dispute that may arise out of this seeming contradiction or harmony, insurance companies then devised the so called "Receipt of Payment Clause" which provides that notwithstanding anything contrary contained within the policy, the insurance will be deemed valid and binding upon the Company only when the premium and documentary stamps therefore have actually been paid in full and duly acknowledged in an official receipt signed by an authorized official/representative of the company.

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41. *Id.* at 68.
42. Executive Vice President, AIC Development Corporation.
43. Partner, Pelaez, Jalandoni, Jamir, and Adriano Law Office.

> Supplementing this clause, a Credit Agreement Clause was also devised in order not to be too harsh. For without such it would mean that a policy would be of no use to anybody even if released, unless the premium and documentary stamps are paid for.
>
> This was the situation at the time the new Insurance Code came to effect. Under the New Insurance Code, Section 60 was slightly amended and incorporated into it as Section 78 and Section 72 was also incorporated into it as Section 77 with a very important amendment, which is the phrase "Notwithstanding any agreement to the contrary."
>
> Section 77 under the new Code now provides that a policy is not valid and binding unless and until the premium is paid just like Section 72. The difference lies in the phrase "Notwithstanding any agreement to the contrary." In other words, the present practice of giving credit agreement is void and of no effect. It would seem that henceforth, premiums must be paid immediately when insurance are purchased.[44]

Atty. Adriano further confirmed this observation of Mr. Y.H. Uy when he said:

> Mr. Uy observed that certain provisions of the new Code have rendered doubtful the continued enforceability – or even validity – of some standard fire policy conditions which, under the regime of the old law, have served the insurance industry wisely and well.
>
> To our mind, two of the several policy conditions mentioned by Mr. Uy merit special attention. This, for a two-fold reason: first, one has to do with a matter – that of "premiums" – which insurers hold most dear above … anything else, and the other relates to a matter – that of "policy cancellation" – the right to exercise which with minimum constrictions, the insurers deeply cherish as a tested measure of protection; and second, as regards them, the new Insurance Code has wrought radical changes in old precepts, which definitely pose problems of no mean proportions to the fire insurance business.
>
> Let us take the matter of "premiums," Section 77 of the Insurance Code – as Mr. Uy pointed out – has rendered "credit agreements" for premium payments no longer efficacious. When customarily, the insured is given up to 60 days within which to pay premiums, during which period of the "credit extension" he enjoys fire insurance coverage under the policy by implicit mandate of the old law, the new Insurance Code imposes a draconian rule which, in net, states: "no premium, no insurance." Worse, the parties cannot agree otherwise. In this age when transaction[s] on credit

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44. *Id.* at 200-201

have become an institution, one can readily appreciate the recessionary effect of the new rule.[45]

B. Other Options Open to the Supreme Court

Indeed, it is almost axiomatic that timely payment of premiums is essential to the validity of an insurance contract. In *Constantino v. Asia Life Insurance Co.*[46] the failure by the insured to make payments, despite the onset of World War II and the subsequent impossibility to pay, had the effect of abrogating the contracts.[47] In that case, the supervening impossibility of performance, through no fault of the insured, had no effect whatsoever on the continued existence of the policy.

Essentially, the underlying theory of timely payment is the basis for Section 77. As the Court has previously held, it is the act of paying the premiums that gives rise to the concurrent obligation of the insurer to indemnify the insured in case of loss.[48] And, compliance by the insured with the terms of the contract is a condition precedent to his right to demand indemnification.[49]

The time of payment being essential to the contract, might it not then have been easier for the Court to consider the credit extension as falling within the ambit of one of the other exceptions, rather than creating an entirely new category on its own? Was it not treading dangerous waters by loosely incorporating an *obiter dictum* of a case whose factual antecedents varied with the instant case?

Indeed, it might have been far more practicable for the Court to construe both the credit term in the instant case and the installment payments in *Makati Tuscany* as being covered by Section 78 of the Insurance Code of 1978, something which was, in fact, already alluded to. Section 78 states:

An acknowledgment in a policy or contract of insurance of receipt of premium is conclusive evidence of its payment, so far as to make the policy

45. *Id.* at 203-204.

46. Constantino v. Asia Life Insurance Co., 87 Phil. 248 (1950).

47. *Id.* at 258.

48. *Phil. Phoenix*, 20 SCRA at 1272.

49. Verendia v. Court of Appeals, 217 SCRA 417, 423 (1993).

> binding, notwithstanding any stipulation therein that it shall not be binding until the premium is actually paid.

In both *Makati Tuscany* and the instant case, the insurer acknowledged receipt of premiums, albeit either in partial fulfillment of the insured's obligation or in its late payment thereof. Though the law is generally construed to cover a situation where non-payment is excused by acknowledgment, then all the more reason there is to similarly apply it to cases wherein payment is made irregularly – as in the instant case or in that of *Makati Tuscany* – and subsequently acknowledged by the insurer. In fact, did the Court not exercise the same kind of freedom of interpretation when it excepted credit arrangements from Section 77?[50]

The effect, of course, would be the same: the policy will be found binding between the parties.[51]

There is also the possibility of waiver alluded to in *Tibay v. Court of Appeals*.[52] There, the court recognized waiver as possible to deny the insurer the chance to disclaim liability. In doing so, it discussed both *Philippine Phoenix* and *Makati Tuscany*, mentioned above – the former displaying an express waiver of the insurer manifested by its suing for the balance of the premium, and the latter an implied waiver evidenced by the agreement to accept payment in installments.

The construction of the terms of a contract which would amount to impairment or loss of right is not favored; conservation and preservation, not waiver, abandonment or forfeiture of a right, is the rule.[53] But, voluntary agreements which provide for reasonable terms, or which show a clear and unmistakable intention of a party to give up a right will be upheld as valid.[54] Could not the credit extension have then been considered as a waiver on the

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50. *See* HECTOR S. DE LEON, THE INSURANCE CODE OF THE PHILIPPINES ANNOTATED 254-255 (2002 ed.). De Leon, however, argues for the validity of credit extensions, using mainly § 78 of the Insurance Code, art. 1306 of the New Civil Code, and the unfairness of allowing the insurer to accept late payments only to declaim the policy when indemnification is sought by the insured.

51. *Id.*

52. *Tibay*, 257 SCRA at 137 (1996).

53. Ridjo Tape & Chemical Corp. v. Court of Appeals, 256 SCRA 544, 552 (1998).

54. *See* Asian Alcohol v. NLRC 305 SCRA 416, 436 (1999) and Gatchalian v. Delim, 203 SCRA 126, 132 (1991).

part of UCPB when it continuously and habitually accepted premium payments past their due dates pursuant to its own voluntary practice?

This leads us to the second tier of the High Court's *ratio* for allowing credit extensions – the characterization of such agreement as an estoppel on the part of the insurer. In the instant case, the Court held:

> [It] would be unjust and inequitable if recovery on the policy would not be permitted against Petitioner, which had consistently granted a 60- to 90-day credit term for the payment of premiums despite its full awareness of Section 77. Estoppel bars it from taking refuge under said Section, since Respondent relied in good faith on such practice. Estoppel then is the fifth exception to Section 77.[55]

Even without having to enter into a discussion of credit extensions – already shown above to be of doubtful legislative basis – estoppel, by itself, would serve to validate the claim of Masagana. Upholding the credit arrangement would have been mere superfluity; the use of estoppel therefore as the sole basis for upholding the contracts immediately obviates the difficulty of avoiding the inherent pitfalls related to credit arrangements. This sentiment is echoed in the abovementioned Court of Appeals disquisition in *Makati Tuscany*, wherein the appellate court held: "*[at] the very least*, both parties should be deemed in estoppel to question the arrangement they have voluntarily accepted." [56]

However, as mentioned above, estoppel, as an exception to Section §77 has its own potential drawbacks. Suffice it to say, for the purposes of this discussion, that the Supreme Court, in deciding the instant case, was not without other available, and perhaps more pertinent, avenues of reasoning in allowing the claim of Masagana. It could very well have decided one way or the other, and in so doing, would have avoided the rather dubious exception midwifed into jurisprudence by the instant case.

VI. CONCLUSION

It does appear then that the Supreme Court may have overlooked the reasons behind the deletion of credit agreements in Section 77 of the Insurance Code of 1978. It is also possible that the historical background of

55. *UCPB*, 356 SCRA at 318.

56. *Makati Tuscany*, 215 SCRA at 468 (emphasis supplied).

Section 77, as presently worded, may not have been fully appreciated by the counsels of the affected litigant in the UCPB case because they failed to emphasize such legislative intent in their pleadings. Since the latest UCPB case has pronounced that credit agreements are still valid notwithstanding the historical background of Section 77, the non-life insurance industry is faced with the following options:

First, accept the latest UCPB ruling on credit agreements as jurisprudence and continue entering into credit agreements with their clients. Many non-life insurance companies still do it anyway. Now, they have a clear legal basis to do so and do not have to feel guilty about it;[57]

Second, adhere to the original industry position that credit agreements are not allowed under Section 77 and hope that in a future case, the Supreme Court will overrule itself. With most of the justices who concurred in the majority decision in the latest UCPB case still far from retirement age however, an overrule seems far-fetched;

Third, lobby with Congress to amend Section 77 to express in clearer terms that credit agreements are not allowed and will invalidate any insurance policy that is incorporated with one. As discussed previously, this was the original position of the industry when the Insurance Code of 1978 was drafted. Yet, with many non-life insurance companies veering from this position by continuing to enter into credit agreements, notwithstanding the present wording of Section 77, would the industry still stick to its original position?

Finally, another alternative is to work for an amendment which would require the premium of the initial non-life policy to be paid, with all subsequent renewals carrying a 30-day credit agreement. This would be akin to life insurance policies, where the initial premium must first be paid before the policy takes effect and all subsequent premiums are subject to a grace period of 30-days or one month.[58] If the life insurance industry can enforce this, why not the non-life industry? Seldom do life insurance companies face lawsuits similar to the UCPB case, where an insurance company's right to deny liability on the ground of non-payment of premium is questioned.

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57. As mentioned above, Masagana itself alleged the prevalent practice in the insurance industry in granting credit agreements as one of its bases for its claim against UCPB.

58. INSURANCE CODE, § 227(a).

The fourth option looks fair and reasonable to both insured and insurer in the face of current practices in the non-life insurance industry. It is something for them and our legislators to think about.