Republic of the Philippines
SUPREME COURT
Manila

EN BANC

G.R. No. 94913 July 23, 1991

D.M. CONSUNJI, INCORPORATED, petitioner,
vs.
THE COMMISSION ON AUDIT, respondent.

Castillo, Laman, Tan & Pantaleon for petitioner.

GUTIERREZ, JR., *J.:p*

This petition seeks to set aside the decision of the Commission on Audit which denied the appeal of the petitioner from the Notice of Audit Disallowance No. FA-001 issued by the Corporate Auditor of the Metropolitan Waterworks and Sewerage System (MWSS) in connection with the petitioner's Contract for Pump Lift Station and Rehabilitation: Tondo Pump Station (Contract No. PS-1) with the MWSS. The Corporate Auditor ruled that the petitioner had received a price escalation overpayment in the amount of P3,900,605.45 and demanded reimbursement from the petitioner.

In March 1981, the MWSS advertised in metropolitan newspapers on several dates an invitation for the public bidding of the contract known as "Contract for Pump/Lift Stations and Rehabilitation: Tondo Pump Station" or "Contract No. PS-1." The project was partly financed through a loan from the Asian Development Bank.

On May 27, 1981, the international competitive bidding for the contract was held. The bidders were A. L. Sarmiento, Erectors Inc., and petitioner D.M. Consunji, Inc. The bids were evaluated in accordance with the Implementing Rules and Regulations of Presidential Decree No. 1594. The lowest bid was submitted by A.L. Sarmiento. After some clarifications on the bid price, however, MWSS found that A.L. Sarmiento had not complied with the conditions of the call for bid and was not entitled to the award of the contract.

The contract was then awarded to Erectors Inc., the second lowest bidder. The contract was finalized and submitted to the Office of the President for approval. However, while the contract was awaiting Presidential approval, Erectors Inc. withdrew therefrom.

In a letter dated August 9, 1982, Oscar I. Ilustre, the then General Manager of the MWSS offered the contract to the petitioner, to wit:

> D.M. CONSUNJI, INC. 1881
>
> Pres. Quirino Ave. Ext.
>
> Pandacan, Metro Manila
>
> SUBJECT: Contract No. PS-1
>
> *Tondo Sewage Pump Station Construction*
>
> S i r s:
>
> This refers to the bidding on subject contract held on 27 May 1981 wherein you are one of the bidders. We have been unsuccessful in entering into contract with bidders which submitted lower bids. Pursuant to P.D. 1594, we are, therefore, inquiring if you can perform the works called for in subject contract at a base contract amount of P68,394,000. If not, then the project will be rebid.
>
> In your response, please consider four items relative to the contract price. First, the two prime cost items (11-5 and I-1-a) shall be converted to regular pay items at prices determined by you; second, escalation provisions of the contract documents shall remain in effect from the date of bidding and to be applied to the base contract amount; third, Annex No. 1 revising the contract documents, shall be incorporated in subject contract; and fourth, qualified commitment procedures of the Asian Development Bank for financing imported materials and equipment shall be availed of.
>
> We request that you review the subject contract based on the above and categorically state whether or not you are in position to accept contract for the base amount specified. If we do not hear from you positively within fourteen (14) days from receipt of this letter, we will proceed to rebid the contract. (*Rollo*, p. 56; Annex "E")

The petitioner accepted the MWSS offer subject to certain modifications which MWSS accepted.

On October 1, 1982, the MWSS Board of Trustees adopted Resolution No. 132-82 awarding the contract to the petitioner, the pertinent portion of which reads:

> RESOLVED, that the award of a negotiated contract to D.M. CONSUNJI for the construction of Contract No. PS-1, is hereby approved in the amount of

> P71,943,000.00 only in lieu of P73,945,000.00 as originally recommended, it being understood that the original contract time shall remain at 912 calendar days from date of issuance of Notice to Proceed, but without prejudice however to the application of the bonus provision for early completion, as provided for in P.D. 1594, as amended and provided that there is no contract time suspension or extension during the effectivity of the contract. (*Rollo*, p. 57; Annex "F")

On October 5, 1982, MWSS and the petitioner entered into a letter-agreement (Annex "G", Petition) awarding the contract to the latter.

On December 14, 1982, the parties executed the Contract for Pump/Lift Stations Rehabilitation: Tondo Pump Station (Contract No. PS-1). On the same date the contract was submitted for Presidential approval.

On April 3, 1983, after Presidential approval of the contract, the petitioner commenced work on the project.

On August 26, 1985, 37 days ahead of October 2, 1985, the contract expiry date, the petitioner completed the project. MWSS fielded its personnel as of September 7, 1985 to assist in the operation of the station, took over the power costs and has since then been using the said facility.

As a result of the early completion of the project, the petitioner claimed from MWSS an "incentive bonus" pursuant to Article V (Completion Time: Liquidated Damages [Incentive Bonus] of Contract No. PS-1 which was paid by the MWSS.

Pursuant to the escalation clause of the contract, the MWSS also paid the petitioner a price escalation of P24,883,439.71.

Upon review of the payments of the price escalation, however, the Corporate Auditor of MWSS, State Auditor IV Lucita C. Sanchez, disallowed the amount of P3,900,605.45 representing alleged overpayment. Thus, in her March 7, 1988 Notice of Audit Disallowance No. FA-001 (Annex C, Petition), Sanchez informed Administrator Luis Sison of the disallowance based on the following findings:

> As based on the attached computations prepared by the undersigned, it appeared that the allowable escalation as of August, 1985 for work accomplished by the contractor is only P20,982,834.25 and not P24,883,439.71 which was paid to the contractor.
>
> The discrepancy between the price escalation computed is fundamentally in the reckoning date for the Allowable Escalation Rate. Reckoning date for price escalation should be October 1, 1982 as stated in the contract and not May, 1981 which was used in the computation of price escalation that was paid to the

> contractor. Letter of the then General Manager of MWSS to the former President of the Philippines also shows that the original contract amount of P71,943,000.00 already includes escalation from the date of bidding to September 30, 1982 and therefore escalation shall begin at October 1, 1982.
>
> In view hereof, the contractor is overpaid by P3,900,605.45. Attached are all the computations prepared by the undersigned. (*Rollo*, P. 37-1 Annex "C")

MWSS then advised the petitioner of the Notice of Audit Dis-allowance and demanded reimbursement of the P3,900,605.45 alleged overpayment.

The petitioner, however, in its reply-letter opined that there was no escalation overpayment on the ground that:

> xxx xxx xxx
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> . . . Since the escalation from date of bidding on 27 May 1981 to 30 September 1982 has already been included in the contract amount, the additional price escalation for the duration of the contract should be (AER) should be reckoned from the month of bidding, which is May 1981 as provided for in the COA Circular 267 as amended.
>
> Using May 1981 as the reckoning date for computing the AER, the price escalation paid to the contractor are within the allowable limits as shown in Annex B. (*Rollo*, p. 66; Annex "K")

The MWSS Corporate Auditor insisted that there was overpayment of price escalation. Hence, the MWSS reiterated its demand upon the petitioner for reimbursement of the amount of P3,900,605.45.

On October 12, 1988, the petitioner filed an appeal with the Commission on Audit (COA) reiterating its stand that it had not been overpaid. The petitioner stated that:

> 1. The "AER" should be reckoned from May 1981, the bidding date because the contract is a bidded contract and not a negotiated contract.
>
> 2. The "actual pace escalation" itself should be and was in fact reckoned from October 1982 because the escalation from May 1981 to September 1982 was incorporated in the base contract price.
>
> 3. By using May 1981 as the reckoning date for the AER, the actual price escalation paid falls within the 30% limit and there is no need for Presidential approval. (*Rollo*, p. 12)

On August 18, 1989, the COA issued a decision dismissing the petitioner's appeal on the ground that Contract No. PS-1 is not a bidded contract but a negotiated contract. The COA stated:

xxx xxx xxx

> Upon a thorough evaluation of these papers, it appears clear that MWSS had to secure authority from the Presidential Executive Committee to negotiate with your company *before* approving the award thereto of subject "negotiated contract" pursuant to Resolution No. 132-82 adopted by the MWSS Board of Trustees on October 1, 1982. Markworthy also is the fact that your firm was actually the*highest bidder*, and that the other two lowest bidders (A.L. Sarmiento and Erectors, Inc.) failed to get the award. In the face of these actualities, this Commission cannot now surmise how subject contract with your firm can be considered as the result of a public bidding. Besides, it is significant to note that the contract price finally agreed upon after negotiation is not the *bid* price offered by your firm, thereby indubitably demonstrating that subject contract is *not a bidded* one.

Upon motion for reconsideration filed by the petitioner, COA issued another decision dated July 24, 1990 dismissing the motion.

Hence, this petition.

The pivotal issue raised in the petition centers on whether Contract No. PS-1 is a bidded contract or a negotiated contract. A corollary issue is whether or not the petitioner was overpaid in the amount of P3,900,605.45 representing price escalation of the contract.

In the earlier case of Danville Maritime, Inc. v. Commission on Audit (175 SCRA 701, 710 [1989]) we defined the role of COA in this wise:

xxx xxx xxx

> . . . No less than the Constitution has ordained that the COA shall have exclusive authority to define the scope of its audit and examination, establish the techniques and methods required therefore, and promulgate accounting and auditing rules and regulations, including those for the prevention and disallowance of irregular, unnecessary, excessive, extravagant, or unconscionable expenditures, or use of government funds and properties. (Art. IX, D. Sec. 2(2), 1987 Constitution of the Philippines)

This constitutional mandate, however, does not confer absolute discretion because the COA's auditing procedures must be within legal constraints. In the instant case, there is no dispute that Contract No. PS-1 is governed by Presidential Decree No. 1594 which prescribes policies, guidelines, rules and regulations for government infrastructure contracts. Pursuant to Section

12 of P.D. 1594, the "Implementing Rules and Regulations for Government Infrastructure Projects in Pursuance of P.D. 1594" were promulgated in 1982.

Section 4 of P.D. 1594 states:

> *Bidding*. — Construction projects shall generally be undertaken by contract after competitive public bidding. Projects may be undertaken by administration or force account or by negotiated contract only in exceptional cases where time is of the essence, or where there is lack of qualified bidders or contractors, or where there is a conclusive evidence that greater economy and efficiency would be achieved through this arrangement, and in accordance with provisions of laws and acts on the matter, subject to the approval of the Ministry of Public Works, Transportation and Communications, the Ministry of Public Highways, or the Minister of Energy, as the case may be, if the project cost is less than P1 Million, and, of the President of the Philippines, upon the recommendation of the Minister, if the project cost is P1 Million or more.
>
> xxx xxx xxx

The implementing rules provide:

> IB 2.5 AWARDING OF CONTRACT
>
> IB 2.5.1 BY BID CONTRACT
>
> 1. The lowest bid/tender should be accepted if it has complied with all conditions in the call for bids/tenders. Except as otherwise provided by international agreements or commitments, no award of contract shall be made to a bidder whose bid price is higher than the allowable government estimate, (AGE). The AGE is the average of the AGE and the average of all responsive bids/tenders. Neither shall any award be made to a bidder whose bid price is less than seventy percent (70%) of the AGE.
>
> xxx xxx xxx
>
> 3. In the event of refusal, inability or failure of the lowest bidder/tenderer to make good his bid/tender by entering into contract and to post his performance bond/security within the time provided therefor, the second lowest bidder/tenderer shall be considered provided that his bid/tender is lower than the sum of the price of lowest bidder/tenderer plus the amount of the forfeited bid/tender bond or he reduces his bid/tender to this sum. This rule shall likewise apply to the third lowest complying bidder in case the second lowest complying bidder shall refuse.

> 5. *If the bidders/tenderers are not willing to reduce their bids / tenders described above, the project may be advertised anew for bidding*, however, only one rebidding, based on the same set of conditions, may be allowed. If after rebidding, no bid/tender still comes within the bid/tender Acceptable to the Government the project may be recommended to the Head of office/agency/corporation concerned for prosecution by administration or by negotiated contract in accordance with existing laws, rules and regulations. The Head of office/agency/corporation shall endorse the same to the Minister for approval. (Emphasis supplied)

Parenthetically, P.D. 1594 and its implementing rules are clear to the effect that infrastructure projects are awarded in the order of priority as follows: First, by public bidding and second by a negotiated contract. However, resort to negotiated contract is only after a failure of public bidding. Furthermore, the implementing rules are clear as to when there is a failure of public bidding after which a negotiated contract may be availed of. Thus, if no bid is acceptable in accordance with the implementing rules during the first bidding, the project should again be*advertised* for a second bidding and in the event the second bidding fails anew, a negotiated contract may be under-taken.

It follows from the law and the rules that the subject Contract PS-1 No. 1 was a bidded contract. The petitioner was one of the three bidders in the initial bidding of the Contract for Pump/Lift Station and Rehabilitation: Tondo Pump Station. Although the petitioner was the highest bidder, it got the contract after the lowest bidder A.L. Sarmiento was disqualified and the second lowest bidder Erectors Inc. withdrew its contract before it could be approved by the President. A suggestion from the Solicitor General that there was failure of the first public bidding when the second lowest bidder withdrew its contract paving the way for an award of a negotiated contract to the petitioner is without basis.

The then General Manager of MWSS in its August 9, 1982 letter offering the contract to the petitioner clearly indicates that such offer was in line with the public bidding. Thus, the letter states:

> This refers to the bidding on subject contract held on 27 May 1981 wherein you are one of the bidders. We have been unsuccessful in entering into contract with bidders which submitted lower bids. Pursuant to P.D. 1594, we are, therefore, inquiring if you can perform the works called for in subject contract at a base contract amount of P68,394,000. *If not, then the project will be rebid*. (*Rollo*, p. 56; Annex "E"; Emphasis supplied)

xxx xxx xxx

The negotiations on details that followed between the petitioner and MWSS do not necessarily categorize the contract a negotiated one. Section 3 of IB 2.5 under IB 2.5 quoted earlier

authorizes negotiations with the higher bidder when the lower bids turn out to be unacceptable to the government.

The rules as regards awarding of contracts were adopted by the COA in its Circular No. 86-264 which prescribes the general guidelines for the divestment or disposal of assets of government-owned and/or controlled corporations, and their subsidiaries, to wit:

> 4.1.4.
>
> xxx xxx xxx
>
> b. If the first bidding fails, re-advertise and conduct a second bidding.
>
> c. the second bidding fails, a negotiated sale may be resorted to subject to the approval of the Commission on Audit.

In interpreting this procedure, we stated in the case of *Danville Maritime, Inc*. *v*. *Commission on Audit, supra*:

> Under COA Circular No. 86-264 herein above reproduced, it is provided that if the first bidding fails, a second bidding must be conducted after advertising same. It is only when the second bidding fails that a negotiated sale may be undertaken. . . .

So we rule also applying the implementing rules of P.D. 1594 that in the awards of infrastructure projects, a negotiated contract ensues only after a failure of the first and second biddings and after properly advertising the second bidding.

In the instant case, there is no evidence to show that a second bidding was considered and advertised. In fact, no second bidding was conducted. Accordingly, Contract No. PS-1 cannot be treated as a negotiated contract.

Moreover, the MWSS itself acknowledged that Contract No. PS-1 is a bidded contract. Thus, in a letter dated May 2, 1990 from MWSS Administrator Luis V. Z. Sison addressed to Mr. Isidro A. Consunji, Executive Vice-President of the petitioner, Sison stated that "As far as this office is concerned, and based on MWSS records, our interpretation of Contract No. PS-1 is that it is a bidded contract." (Annex "A", Reply)

As regards the issue of price escalation, Article V of Contract No. PS-1 states:

ESCALATION CLAUSE

> 6.01 It is expressly agreed by both parties that the provisions and guidelines for computation and payment of price escalation on infrastructure contracts of the Implementing Rules and Regulations of P.D. 1594, as amended and approved in 17 June 1982 shall be used as the basis for computation of price escalation reckoned from 1 October 1982. (*Rollo*, p. 48)

Considering our finding that Contract No. PS-1 is a bidded contract, reckoning the date for price escalation from October 1, 1982 as provided for in the contract at its face value and as interpreted by COA, instead of May 27, 1981 which was the date of bidding would conflict with the reckoning date for price escalation in government contracts as provided for under the implementing rules and regulations of P.D. 1594, as amended and COA Circular No. 267, to wit:

xxx xxx xxx

> 5. Price escalation shall be reckoned from the month of bidding of the project and shall be allowed for every progress billing but not oftener than once every month. When the contract has not been subject of competitive bidding, price escalation shall be reckoned from the month agreed upon in the contract and shall be granted for every progress billing but not oftener than once a month. In all cases, price escalation shall apply only to the work done within the period for which the price escalation was determined. (Item CI 11, IIR/PD 1594)

xxx xxx xxx

> A. Computation for the Escalation
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> The computation for the escalation itself shall be reckoned from the date of bidding, for bidded contracts, or the date agreed upon in the contract, for negotiated contracts. (COA Circular No. 267)

In effect, COA's interpretation of the provision in the contract would contravene the well-entrenched rule that existing laws form part of a contract:

> Petitioner's point is that if the Margin Law were applied, it "would have paid much more to have the continuing benefit of reinsurance of its risks than it has been required to do so by the reinsurance treaty in question" and that "the theoretical equality between the contracting parties . . . would be disturbed and one of them placed at a distinct disadvantage in relation to the other."
>
> This pose at once loses potency on the face of the rule recognized that existing laws form part of the contract "as the measure of the obligation to perform them by the one party and the right acquired by the other." (I Cooleys

Constitutional Limitations, 8th ed., p. 582) Stated otherwise, "[t]he obligation does not inhere, and subsist in the contract itself, *propio vigore*, but in the law applicable to the contract." (Ogden v. Saunders, 6 L. ed., pp. 606, 642 [Opinion of Mr. Justice Trimble]). (Phil. American Life Ins. Co. v. Auditor General, 22 SCRA 135, 143) [1968] See also Maritime Company of the Philippines v. Reparations Commission, 40 SCRA 70 [1971]).

Accordingly, the COA committed grave error in reckoning the date of price escalation on October 1, 1982 which was the date provided for in the contract.

The given date of October 1, 1982 provided for in the contract was satisfactorily explained by the petitioner as follows:

> . . . [T]he escalation of prices from 27 May 1981 (the bidding date) to September 1982 was already incorporated into the contract. Under the 5 October 1982 letter of the MWSS to the Petitioner (Annex G of the Petition, and incorporated as an integral part of the Contract), it was provided that:
>
> *Escalation*
>
> As requested, the base contract price from the 27 May 1981 will be brought to current, 30 September 1982, prices as follows:
>
> Three Million Five Hundred Forty *P3,540,000.00* Thousand Pesos
>
> TOTAL —
> P71,943,000.00
>
> (Emphasis supplied)
>
> Hence, the Contract gave 1 October 1982 as the date for succeeding price escalations. But the fact remains that price escalation started from May 1981, as in fact the escalation from May 1981 to September 1982 was incorporated into the Contract.
>
> It must be remembered that the erroneous basis of the respondent's decision is the reckoning of the Allowable Escalation Rate from 1 October 1982 only. Clearly, respondent is in error since it cannot disregard the fact that the price escalation started from May 1981, the date of bidding. This is shown by par. 2 if the just quoted 5 October 1982 letter of the MWSS, Likewise, there is support in COA Circular No. 267 which says that the computation for escalation itself (not that the Allowable Escalation Rate) "shall be reckoned from the date of bidding for bidded contracts." As mentioned, escalations from May 1981 to September 1982 were already incorporated into the Contract and Art. VI thereof governed

> escalation from 1 October 1982 only. Since it was from 27 May 1981 that the escalation was paid by incorporating it into the Contract, it necessarily follows that the Allowable Escalation Rate should be reckoned from the same date of 27 May 1981. (*Rollo*, pp. 139-140)

Considering the above findings, we rule that the COA committed grave abuse of discretion in requiring reimbursement in the amount of P3,900,605.45 representing price escalation of the contract from the petitioners.

WHEREFORE, the instant petition is GRANTED. The questioned decisions of respondent Commission on Audit as well as the Notice of Audit Disallowance No. FA-001 of the Corporate Auditor of the MWSS are hereby REVERSED and SET ASIDE. No costs.

SO ORDERED.

Fernan, C.J., Narvasa, Melencio-Herrera, Cruz, Paras, Feliciano, Gancayco, Padilla, Bidin, Sarmiento, Griño-Aquino, Medialdea, Regalado and Davide, Jr., JJ., concur.