

REPUBLIC OF THE PHILIPPINES
GOVERNMENT PROCUREMENT POLICY BOARD
Technical Support Office
Mezzanine 125, Mabini Hall, Malacañang, Manila
Telefax Nos. (02) 735-4962; (02) 736-5758

NPM No. 105-2004

August 3, 2004

Mr. REYNALDO D. RIVERA
Major General
Armed Forces of the Philippines
Office of the Deputy Chief of Staff for Capability
Camp General Emilio Aguinaldo, Quezon City

Re : **Issuance of Letter of Credit to Joint Ventures**

Dear Major General Rivera:

This refers to your letter dated July 27, 2004, which we received through facsimile on even date, addressed to the Honorable Secretary Emilia T. Boncodin as Chairperson of the Government Procurement Policy Board ("GPPB"), requesting for clarification on these issues:

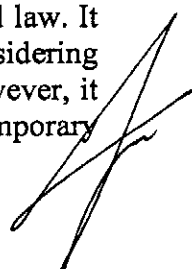
- a) Whether or not a letter of credit may be issued in favor of a joint venture composed of a Philippine entity and a foreign manufacturer/supplier, or on any of the members thereof; and
- b) Whether or not a letter of credit may be issued in favor of the foreign member of the joint venture in behalf of the members.

This query was made in connection with the implementation of the Armed Forces of the Philippines ("AFP") Modernization Program. Apparently, your agency is in a predicament whether it can issue a letter of credit in favor of a joint venture composed of Philippine and foreign entities.

Nature of Joint Venture

Before we answer the issues presented to us, it is relevant to discuss first the nature of joint venture as a legal concept vis-à-vis the legislative and jurisprudential treatment of such arrangement in Philippine jurisdiction.

It must be understood that joint ventures are of recent origin in commercial law. It has no precise category as a legal entity under the Philippine legal parlance, considering that such is not specifically defined under our civil and commercial statutes. However, it has been generally understood to mean an organization formed for some temporary



purpose.¹ Black's Law Dictionary² defines joint venture as:

A legal entity in the nature of a partnership engaged in the joint prosecution of a particular transaction for mutual profit. (Tex-Co Grain Co. v. Happy Wheat Growers, Inc., Tex.Civ.App., 542 S.W.2d 934, 936). An association of persons jointly undertaking some commercial enterprise. It requires a community of interest in the performance of the subject matter, a right to direct and govern the policy in connection therewith, and a duty which may be altered by agreement, to share both in profit and losses. (Russell v. Klein, 33Ill.App.3d 1005, 339 N.E.2d 510, 512.)

xxx

xxx

xxx

In the case of *Kilosbayan, Inc. et. al. v. Guingona et. al*³, 232 SCRA 110 (May 5, 1994), the Supreme Court has adopted Black's definition of joint venture, when it said:

A careful analysis and evaluation of the provisions of the contract and a consideration of the contemporaneous acts of the PCSO and PGMC indubitably disclose that the contract is not in reality a contract of lease under which the PGMC is merely an independent contractor for a piece of work, but one where the statutorily proscribed collaboration or association, in the least, or joint venture, at the most, exists between the contracting parties. Collaboration is defined as the acts of working together in a joint project. Association means the act of a number of persons in uniting together for some special purpose or business. **Joint venture is defined as an association of persons or companies jointly undertaking some commercial enterprise; generally all contribute assets and share risks. It requires a community of interest in the performance of the subject matter, a right to direct and govern the policy connected therewith, and duty, which may be altered by agreement to share both in profit and losses (citing Black's Law Dictionary). (supra, p. 143-144). [Emphasis supplied]**

From the foregoing definitions, particularly Black's which our own Supreme Court has recognized, a joint venture is said to exist when the following general characteristics become evident:

1. An association of persons or companies is established to undertake jointly some commercial enterprise or to achieve a common purpose or objective.
2. These persons or companies contribute money, property, industry, knowledge, skill or some other identifiable asset.
3. These parties have (1) a community of interest in the performance of the

¹ Gates v. Megargel, 266 Fed. 811 [1920].

² 5th ed. [1979], p. 753.

³ See also Information Technology Foundation of the Philippines, et.al, vs. COMELEC, et.al., G.R. No 159139 (January 13, 2004).

subject matter; (2) a right to direct and govern management; and (3) an agreement, express or implied, to share in the profits, risks and losses.

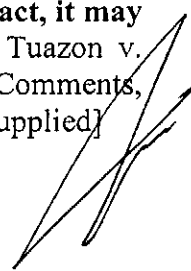
Joint Venture and Partnership

It can be observed based on the above discussion that the characteristics of a joint venture is akin to a partnership relation. However, it can be deduced from the definitions above that a joint venture is a status short of a partnership, at least not a formal partnership in the legal or technical sense. Significantly, joint ventures differ from partnerships in the following ways:

1. A joint venture does not have a legal personality distinct and separate from the parties composing it, while a partnership does.
2. A joint venture usually has for its object an undertaking of a single or ad hoc nature, although it may entail a series of transactions and may last for a considerable period of time; a partnership usually has for its object a general business of a particular kind, although there may be a partnership for a single transaction.
3. Corporations may enter into joint ventures; corporations are not eligible for membership in a partnership.⁴

However, the distinction and correlation between the two legal concepts is further explained by the Supreme Court in the case of **Auerbach vs. Sanitary Wares Manufacturing Corporation** (180 SCRA 130 [1989]), to wit:

The main distinction cited by most opinions in common law jurisdictions is that the partnership contemplates a general business with some degree of continuity, while the joint venture is formed for the execution of a single transaction, and is thus of a temporary nature. (Tuffs v. Mann 116 Cal. App. 170, 2 P. 2d. 500 [1931]; Harmon v. Martin, 395 Ill. 595, 71 NE. 2d. 74 [1947]; Gates v. Megargel, 266 Fed. 811 [1920]). This observation is not entirely accurate in this jurisdiction, since under the Civil Code, a partnership may be particular or universal, and a particular partnership may have for its object a specific undertaking. (Art. 1783, Civil Code). **It would seem therefore that under Philippine law, a joint venture is a form of partnership and should thus be governed by the laws of partnership.** The Supreme Court has however recognized a distinction between these two business forms, and has held that **although a corporation cannot enter into a partnership contract, it may however engage in a joint venture with others.** (At p.12, Tuazon v. Bolanos, 95 Phil. 906 [1954] (Campos and Lopez - Campos Comments, Notes and Selected Cases, Corporation Code 1981). [Emphasis supplied]



⁴ See 46 Am Jur 2d 26.

Based on the aforequoted decision, and considering that there is no specific law governing joint ventures, it follows that the law on partnership⁵ governs such relation suppletorily and by analogy. Thus, in matters governed by the joint venture agreement, the specific provisions of said agreement define the relations, rights and obligations of the parties. When the agreement is silent on any particular issue, the general principles of partnership may be resorted to.

In view of the foregoing discussions, it can be concluded that a joint venture has a class of its own. As it is treated as a mere association for some temporary business purpose devoid of any juridical personality, it follows that corporations or entities forming a joint venture retain their respective individual legal personality. Furthermore, considering that the specie of joint ventures is generally contractual,⁶ there is actually no equity participation between the partners and their relations, rights and liabilities as among themselves and in respect of third parties, are principally governed by contract or agreement.

However, there is another form of joint venture that has actual corporate designation, which may be availed of by corporations or entities that desire to carry out a single business venture for joint profit. Hence, in the Philippine legal setting, companies may enter into a so-called "equity joint venture" and form a new joint venture corporation. In this arrangement, a new juridical entity with separate and distinct personality is created, where each partner owns a certain portion of the company. Certain legal requirements also have to be complied with in this arrangement, such as registration with the Securities and Exchange Commission.

Issuance of Letter of Credit in Government Procurement

A reading of Section 42.5 of the IRR-A of R.A. 9184 will reveal that a letter of credit is not allowed to be issued in government procurement either in favor of the following: (i) a Philippine entity; or (ii) any of a Philippine entity's foreign manufacturers or suppliers. Thus:

No procuring entity shall be allowed to issue a letter of credit in favor of a Philippine entity or to any of the latter's foreign manufacturers or suppliers, with respect to any procurement. (Emphasis supplied)

The rationale behind the proscription for the issuance of a letter of credit under this provision is couched on the fact that the same is treated as a form of an advance payment; an eventuality frowned upon by Section 88 of Presidential Decree 1445.⁷ Hence, what is

⁵ Articles 1767-1867 of the Civil Code of the Philippines.

⁶ In Securities and Exchange Commission (SEC) Opinion [April 29, 1985], it was ruled that two or more corporations may enter into a joint venture through a contract or agreement (contractual joint venture) if the nature of the venture is authorized by their charters, which contract need not be registered with the SEC; provided, however that the joint venture will not result in the formation of a new partnership or corporation.

⁷ Section 88. *Prohibition against advance payment on government contracts.* - (1) Except with the prior approval of the President (Prime Minister) the government shall not be obliged to make an advance payment for services not yet rendered or for supplies and materials not yet delivered under any contract therefor. No payment, partial or final, shall be made on any such contract except upon a certification by the head of the agency concerned to the effect that the services or supplies and materials have been rendered or delivered in accordance with the terms of the contract and have been duly inspected and accepted.

actually being prohibited and avoided by Section 42.5 of the IRR-A is the situation where the procuring entity pays the supplier without the goods or services having been delivered. Aside from the prohibition on the use of public funds for private purpose, advance payment is never countenanced for the simple reason that the Government should not fund, directly or indirectly, the business endeavor of a supplier or manufacturer. It is an accepted fact that any entity contracting with the Government for the rendition of services or delivery of supplies and materials is presumed to be 'logistically' prepared for the purpose. The assumption is that it has ready resources to rely upon in the performance of its contractual undertaking. And so, when the Government is requested to make an advance payment under the contract even before a contractor has commenced performance, it can only mean that it is not yet in a financial position to perform its contract. Consequently, if advance payment is allowed, the Government, in effect, provides part of the capital of the contractor and hence, becomes a capitalist of all sorts, which is detrimental to the financial interest and security of the Government.⁸ It is in this context that letters of credit are prohibited to be issued to a Philippine entity or to any of its foreign manufacturers or suppliers.

However, while it is true that IRR-A prohibits the issuance of a letter of credit in favor of a Philippine entity and its foreign manufacturer or supplier, the same is not true when a procuring entity directly contracts with a foreign manufacturer or supplier, in cases of international transactions. Under this arrangement, it is a commercial necessity that a letter of credit be issued, considering that it is the acceptable financial device and the most convenient and relatively safe mode of dealing with sales of goods to satisfy the seemingly irreconcilable interests of a seller, who refuses to part with his goods before he is paid, and a buyer, who wants to have control of the goods before paying.⁹ By its nature, a letter of credit is an instrument issued by a bank, substituting the credit standing of the importer (the buyer) of goods. It guarantees that the exporter (the seller) will be paid if all the terms of the contract are met. At the same time, it protects the buyer by guaranteeing that no payment will be made unless and until that contract is fulfilled.

Thus, Section 42.5 of the IRR-A should not be interpreted as prohibitive of international dealings of the Government when it procures from foreign sources, most especially when the goods to be obtained are not available in the domestic market. Being a product of international commerce, it must be understood that the impact of this commercial instrument transcends national boundaries, and its legal complexities cannot be simply limited by local laws, without transgressing upon the international usages and customs in inter-country commercial transactions.

Applicability of Section 42.5 of the IRR-A of R.A. 9184 to Joint Ventures

With the nature of the juridical relation of joint ventures properly identified, there seems to be an obscurity on how the prohibition for the issuance of letters of credit under Section 42.5 of the IRR-A may be applied to joint ventures, or whether such prohibition is

(2) Notwithstanding the foregoing paragraph, any government agency, with the approval of the proper department head, may furnish supplies and materials to any party who has a contract with that agency if the supplies and materials are needed in the performance of the services being contracted for and the value thereof does not exceed in any one month ten percent of the value of the services already rendered due and unsettled as computed by the agency concerned.

⁸ See Bartolome C. Fernandez, *A Treatise on Government Contracts under Philippine Law*, p. 184 (2001).

⁹ *Bank of America, NT & SA v. Court of Appeals*, G.R. No. 105395, December 10, 1993.

of course, the question on the issuance of letter of credit to joint venture with more than forty percent (40%) foreign interest is relevant only in exceptional cases under Republic Act No. 5183 ("R.A. 5183") and Section 23.11.1 of the IRR-A.

At this juncture, we would like to stress that though the issuance of a letter of credit to a foreign entity is allowed, such issuance must be exercised with caution so as to preclude the situation wherein the Government becomes a capitalist and a financier of the foreign entity, a circumstance frowned upon by Section 88 of Presidential Decree 1445. It must not be forgotten that the issuance of a letter of credit in favor of foreign entities is allowed only to facilitate importation of goods needed by the Government in situations when it is allowed by law to procure from foreign sources, in view of the international usages and customs in inter-country commercial transactions. To protect the interest of the Government, the following conditions may be used as a safeguard check by the AFP before it issues a letter of credit in favor of a joint venture accorded with foreign national treatment:

1. The participation of joint ventures with foreign element in government procurement must be allowed by law, such that it should comply with R.A. 5183 and/or falls within the exceptions under Section 23.11.1 of the IRR-A of R.A. 9184 and the GPPB Guidelines governing the same;
2. The Filipino interest in the joint venture must be less than sixty percent (60%);
3. The foreign co-venturer's participation in the joint venture must be as supplier or manufacturer of goods to be procured;
4. The letter of credit must be issued for the benefit of the foreign co-venturer, who must be acting as the lead representative/agent of the joint venture as stated in their joint venture agreement,¹⁰ and
5. The letter of credit must be issued only to finance foreign importation, whereby the letter of credit is issued by a bank, substituting the credit of that bank for the credit standing of the Government (the importer of goods), thereby guaranteeing that the foreign entity (the exporter) will be paid upon presentation of the documents of title evidencing or attesting to the shipment of goods to the importer and the fulfillment of all the terms of the contract

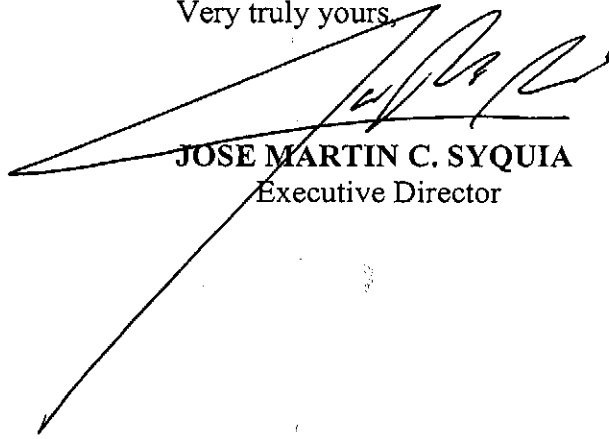
As regards the so-called "equity joint ventures," there is no question that Section 42.5 of the IRR-A may be applied thereto foursquare. Considering that a new joint venture corporation is created in this arrangement, imbued with distinct corporate existence, then the applicability of the rule on the prohibition of issuance of letter of credit under the IRR-A shall depend whether the joint venture corporation is a Philippine national, which shall depend upon the equity participation of each partner or co-venturer.

¹⁰ If not specifically stated who is to act as the lead representative/agent, there is a presumption of equal control. A joint venture, including a partnership, presupposes generally a parity of standing between the joint co-venturers or partners, in which each party has an equal proprietary interest in the capital or property contributed and where each party exercises equal rights in the conduct of the business. [Sevilla et. Al., vs. CA G.R. Nos. L-41182-3. April 15, 1988]. A co-venturer stands as both principal and agent of the other parties with respect of those matters falling within the scope of the joint venture.

With the foregoing extensive discussions, we hope that we have clarified the issue on the issuance of letter of credit to joint ventures. May this serve as a guide in the present and future dealings of the AFP pursuant to its Modernization Program.

We trust that this clarifies matters.

Very truly yours,



JOSE MARTIN C. SYQUIA
Executive Director

REGISTRY RECEIPT

Post Office **437**

Letter/Package No. **177-1078**

Post Office **MALACANANG POST OFFICE**

Preserve this receipt for reference in case of inquiry

Postmaster/Teller