

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. 122-2004

August 27, 2004

ATTY. ALBERTO A. BERNARDO, CESO II
Assistant Executive Secretary
Internal Audit Service
Office of the President, Malacanang

Re: Application of Advance/Down Payment in the Procurement of Goods.

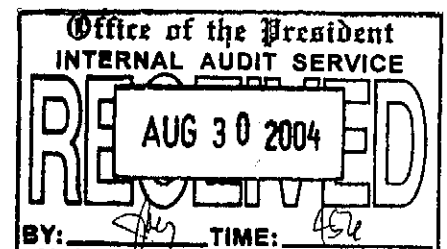
Dear Assistant Secretary Bernardo:

This refers to your letter-query dated 13 August 2004, addressed to the Honorable Secretary Emilia T. Boncodin of the Department of Budget and Management, in her capacity as Chairperson of the Government Procurement Policy Board (GPPB), raising questions as to the proper application of down payment anent the "Department of National Defense (DND)/Armed Forces of the Philippines (AFP) – Alvis Logistics Contract for the Repair and Rehab of Scorpion Tanks."

As stated in your letter, "the peculiarities surrounding the agreement as well as the present circumstances of the case, apparently pose a precedent especially with respect to matters on procurement of goods, as it raise issues which have not been extensively dealt with before." Indeed, the sensitivity and potential outstretch implications of the said contract puts in order an immediate and directed resolution of the issues involved.

As an offshoot of the controversy, the Government Procurement Policy Board (GPPB), during its 6th Regular Meeting¹, tackled the issue and resolved to render its opinion on the matter. Previously, however, discussions have already been had and as a result, the GPPB initially and verbally, held the same stance as that of the Office of the Undersecretary for Internal Control-DND (OUSIC)

¹ On 20 August 2004, 3:00 pm, Taipan Place Emerald Ave., Ortigas Center, Pasig



The case under consideration involves a novel and crucial legal question of the proper application of down payment in the absence of any contractual stipulation relative thereto. Particularly put:

How will the (thirty percent) 30% down payment by the AFP be applied for payment of partial deliveries of the spare parts it procured?

Incidentally, two contending views are posited:

On one hand, the OUSIC believes that the down payment should first be exhausted before another withdrawal from the letter of credit (L/C) is effected (i.e., the initial shipment should have been taken care of by the sixty million pesos (P60.0 million) already in the supplier's possession. And that, succeeding shipments should be billed from the remaining balance of one hundred forty-one million eight thousand one hundred eighty three and 40/100 pesos (P141, 008,183,400.00) only after the sixty million pesos (P60.0 million) is fully spent that withdrawal from the L/C's balance should be allowed).

The Internal Audit Service-Office of the President (IAS-OP)² holds a similar position and opines that the advance payment made is in the nature of a credit extended by the AFP to the supplier and, hence, the first delivery should be paid from the down payment. Hereunder is a reproduction, *in toto*, of the opinion of the IAS-OP:

I. The advance payment made is in the nature of a claim or credit extended by the PA-AFP to the supplier to deliver goods

1. Advance payment as earnest money.

1.1. "Suffice it to point out that in such cases, unlike that under consideration in this opinion, by reason of the consummation of the sale, the so-called "deposit for down payment" cannot be considered as a mere deposit, but is really advance payment of part of the purchase price, the ownership of which is transferred to the seller once given. (See Paras, Civil Code, Vol. V, p. 589, citing Cruz v. Aud. Gen. L-22233, May 30, 1959.)" (underscoring supplied)
Unnumbered DOJ Opinion, 18 September 1969

1.2. "Under Art. 1482 of the Civil Code, whenever earnest money is given in a contract of sale, it shall be considered as part of the purchase price and as

² The Internal Audit Service-Office of the President was tasked to elevate the matter to the GPPB pursuant to their mandate to assist the OUSIC-DND under Section 3 of Executive Order (E.O.) No. 240, to wit:

Section 3. Multi-Sectoral Support. In its task of institutionalizing reforms in the procurement and fund disbursements in the DND and AFP, the following are enjoined to assist the Office of the DND Undersecretary for Internal Control:

Assistant Commissioner Arcadio B. Cuenco, Jr. – Commission on Audit, Assistant Executive Secretary Alberto A. Bernardo – Internal Audit Service, Office of the President, Major General Cicero L. Castellano – Armed Forces of the Philippines, Major General Carlos F. Garcia – Armed Forces of the Philippines, Director Virginia G. Garriel – Department of Budget and Management, Director Ricardo S. San Andres – Association of Government Internal Auditors of the Philippines, Professor Victor S. Limlingan – Asian Institute of Management.

For the purpose of the mandate, duties and functions cited herein, the DND Undersecretary for Internal Control shall be supported by a secretarial staff, the members of which shall be determined and constituted by the Internal Audit Service of the President.

proof of the perfection of the contract. Petitioner clearly stated without any objection from private respondents that the earnest money was intended to form part of the purchase price. It was an advance payment which must be deducted from the total price. Hence, the parties could not have intended that the earnest money or advance payment would be forfeited when the buyer should fail to pay the balance of the price, especially in the absence of a clear and express agreement thereon." (underscoring supplied) **Goldenrod vs. Court of Appeals, G.R. No. 126812. November 24, 1998**

XXX

1.3. "It is a statutory rule that whenever earnest money is given in a contract of sale, it shall be considered as part of the price and as proof of the perfection of the contract. (Article 1482, Civil Code) It constitutes an advance payment and must, therefore, be deducted from the total price. Also, earnest money is given by the buyer to the seller to bind the bargain". (underscoring supplied) **Adelfa Properties, Inc. vs. Court of Appeals, G.R. No. 111238, January 25, 1995**

XXX

1.4. As the advance payment is considered as part of the contract price, the supplier now owes the corresponding value of the goods as enumerated in the quotation considering that the contract price was based from the units specified therein. Pending delivery, it stands as a credit that can be demanded by the AFP-PA as against Alvis Logistics.

2. The PA-Alvis Contract constitutes a reciprocal obligation.

2.1. A reciprocal obligation is "that which arises from the same cause and in which each party is a debtor and a creditor of the other, such that the obligation of one is dependent upon the obligation of the other. Reciprocal obligations are to be performed simultaneously so that the performance of one is conditioned upon the simultaneous fulfillment of the other. **F.B. Moreno, Philippine Law Dictionary, 3rd ed**

XXX

2.1. With the foregoing considered, it is now incumbent upon the vendor to deliver the determinate thing or the equivalent of the advance money which has been paid by the PA. Thus, pending delivery, the obligation by the supplier still stands as debt.

3. The goods yet to be delivered stands as credit on the part of buyer and correlatively as debt by the supplier.

3.1. "Art. 1233. A debt shall not be understood to have been paid unless the thing or service in which the obligation consists has been completely delivered or rendered, as the case may be." **Civil Code of the Philippines.**

3.2. "The term debt is properly used in a comprehensive sense as embracing not merely money due by contract, but whatever one is bound to render to another, either for contract or the requirement of the law. (Camden vs. Fink Coule and Coke Co., 61 ALR 584). **Commissioner of Internal Revenue vs. Carlos Palanca, Jr., G.R. No. L-16626. October 29, 1966**

3.3. The term "credit" in its usual meaning is a sum credited on the books of a company to a person who appears to be entitled to it. It presupposes a creditor-debtor relationship, and may be said to imply ability, by reason of property or estates to make a promised payment (In Re Ford, 14 F. 2nd 848,

849). It is the correlative debt or indebtedness, and that which is due to any person as distinguished from that which he asks. **Republic of the Philippines vs. Philippine National Bank, G.R. No. L-16106. December 30, 1961**

II. The first delivery should be paid from the down payment.

1. Contracts under the general provisions of law.

1.1. "Contracts to which the Government is a party generally are subject to the same rules of contract law which govern the validity and sufficiency of contracts between individuals. That is so because when the Government enters into a contract, it sheds its cloak of sovereignty, descends to the level of the citizen, and is treated by the law as a private person with the same rights and obligations of such individual as are generally governed by the law applicable to contracts between private persons." **Fernandez, Bartolome C, Jr., A Treatise on Government Contracts Under Philippine Law, 1996 ed, p. 9., Commission on Audit – Policy Training and Technical Assistance Facility (COA-PTTAF) Manual on Contracts Review, p. 14, Jante, Milagros S., Handbook on Government Contracts citing Law on Public Bidding and Government Contracts by Cobacha and Lucenario, 91 CJS 60.**

1.1.1. "The agreement or the contract between the parties is the formal expression of the parties' rights, duties and obligations. It is the best evidence of the intention of the parties. Thus, 'when the terms of an agreement have been reduced to writing, it is considered as containing all the terms agreed upon and there can be, between the parties and their successors in interest, no evidence of such terms other than the contents of the written agreement.'" **Arwood Industries, Inc. vs. D.M. Consunji, Inc. G.R. No. 142277, 11 December 2002.**

1.1.2. "Art. 1159. Obligations arising from contracts have the force of law between the contracting parties and should be complied with in good faith." **Civil Code of the Philippines**

1.1.3. " Art. 1458. By the contract of sale one of the contracting parties obligates himself to transfer the ownership of and deliver a determinate thing, and the other to pay therefore a price certain in money or its equivalent." **Civil Code of the Philippines**

1.1.4. "Art. 1497. The thing sold shall be understood as delivered, when it is placed in the control and possession of the vendee." **Civil Code of the Philippines**

2.2. **Executive Order No. 201, "Amending Executive Order No. 107, Dated December 3, 1947, Entitled "Prohibiting the Execution of Government Contracts Wherein the Government is Required to Make Advance Payment for Services Not Yet Rendered and/or Supplies and Materials Not Yet Delivered."**

"As a matter of administrative measure and for the security of the Government, I, Elpidio Quirino, President of the Philippines, by virtue of the powers vested in me by law, do hereby prescribe that, except with the prior approval of the President. x x x" **14 January 1949**

2.2.1. "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 therefore. 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." **Presidential Decree (PD)1445**

2.2.1.1. "Exceptions as a general rule, x x only extend only so far as their language fairly warrants, and all doubts should be resolved in favor of the general provisions rather than the exception. Where a general rule is established by statute with exceptions, the court will not curtail the former nor add to the latter by implication." **Samson vs. Court of Appeals, G.R. No. L-43182. 25 November 1986**

2.2.1.2. "The rationale behind such a prohibition against advance payment is not hard to perceive. Any person 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 he has his own resources to rely upon in the performance of his contractual undertaking. And so, when he asks the Government to pay him in advance under the contract even before he has commenced such performance, it can only mean that he is not as yet in a financial position to perform his contract. In effect, by making such advance payment, the Government provides part of the capital for the contractor, and, hence, becomes a capitalist of sorts. This would be rather unusual arrangement or situation which only the Executive, presumably for extremely or extraordinarily meritorious reasons or a highly justifiable cause, may authorize. It is in this context that the subject prohibition is deemed imposed as a matter of administrative measure and for the security of the Government." (underscoring supplied) **Fernandez, Bartolome C. Jr., A Treatise on Government Contracts Under Philippine law, 1996 ed. pp. 172-173 citing "Executive Order No. 201, s. 1949**

2.3. Down payment is not recouped from the progress deliveries on a pro-rata basis as provided by the following stipulations.

2.3.1. "The SELLER's Representative shall be able to draw down on establishment of the Letter of Credit thirty (30%) of the value of the order, to be considered as a downpayment, upon presentation of Proforma Invoice." **Item 4.3 of Article IV- Terms of Payment of the SSA**

2.3.2. "A delivery schedule shall form part of the SELLER's quotation and shall date from the opening of the Letter of Credit and issuance of the United Kingdom Export License " **Item 6.1, Article VI of the SSA**

2.3.3. Letter of Credit as a mode of payment

2.3.3.1. "x x x The opening of a letter of credit in favor of a vendor is only a mode of payment. It is not among the essential requirements of a contract of sale enumerated in Article[s] 1305 and 1474 of the Civil Code, the absence of any of which will prevent the perfection of the contract from taking place." **Johannes Schuback & Sons Phil. Trading Corp. vs. Court of Appeals, 227 SCRA 719 (1993)**

3. Payment on progress billing/delivery on a pro-rata basis cannot be applied in the procurement of goods.

3.1. "The phrase 'monthly progress billings' refers to a portion of the contract price payable by the owner of the project to the contractor based on the percentage of completion of the project or on work accomplished at a particular stage. It refers to that portion of the contract price still to be paid as

work progresses, after the down payment is made." **Arwood Industries, Inc. vs. D.M. Consunji, Inc. G.R. No. 142277, 11 December 2002.**

3.2. "P.D. No. 1594 is the general law x x x applicable to all government infrastructure contracts throughout the Philippines. This conclusion can readily be drawn from the observation that P.D. No. 1594 was enacted to fill the need to adopt a "comprehensive, uniform, and updated" set of policies, guidelines, rules and regulations for government infrastructure contracts." **Opinion No. 102, s. 1984, 9th Indorsement, July 12, 1984**

3.3. "The cardinal rule in the interpretation of all laws is to ascertain, and give effect to, the intent of the law." **Macondray & Co. vs. Eustaquio, 64 Phil. 446**

3.3.1. "All rules of construction or interpretation have for their sole object the ascertainment of the true intent of the legislature." **Tañada vs. Cuenco, 103 Phil. 1051.**

3.3.2. "Legislative intent is the vital part, the essence of the law. The intent of the legislature is the law, and the key to, and the controlling factor in, its construction or interpretation." **Torres vs. Limjap, 56 Phil 141 (1931)**

On the other hand, the supplier claims that, as done in previous transactions, the down payment is applicable for the entire contract (i.e., for the first shipment to be settled, they need to withdraw again from the L/C the amount equivalent to the cost of the parts to be released which is P30.0 Million). Prescinding from the guidance of the Commission on Audit³ on the matter, the Office of the Undersecretary for Armed Forces Operations-Department of National Defense⁴ opined that the down payment could not be made applicable in whole to the first delivery since this was used to acquire raw materials to produce the spare parts. It argues that no provision in the contract and in the approved Price Quotation sanctions the application of the down payment in the first delivery. Incidentally, the COA suggested that this can be recouped from the progress deliveries on a pro rata basis.

Application of the Thirty Percent (30%) Down Payment

The GPPB affirms its previous stand and concurs with the parallel position of the OUSIC and of the Internal Audit Service-Office of the President (IAS-OP). After further study, it sees no reason to depart from its earlier stand.

The (thirty percent) 30% draw down from the L/C constitutes a claim of the government against the supplier. On the other hand, it represents the standing obligation of the latter to deliver the spare parts commensurate to the amount of the draw down.

The Supply Support Agreement (SSA) between DND/AFP⁵ and Alvis Logistics Limited⁶ was short of expressing the real agreement of the parties as to the purpose and application of the down payment. While the contract authorizes the supplier from drawing

³ Thru Assistant Commissioner Arcadio B. Cuenco, Jr.

⁴ Thru Lt. Gen. Edgardo E. Batenga, AFP (Ret)

⁵ Represented by Lt. Gen. Voltaire T. Gazmin, Commanding general, Phil. Army.

⁶ Represented by Rosario L. Ong.

down a portion of the contract price as down payment, the agreement is silent as to when and how it should be used. Neither does the L/C provide what was missing in the contract. There was nothing on both the contract and the L/C to clarify the application of the down payment as much as the remaining portion of the total contract price.

In sum, while extreme positions of the parties are argued, the absence of any contractual stipulation leaves its interpretation doubtful, thus, warranting the application of pertinent rules of interpretation of contracts as provided under general law, to wit:

“Art. 1378. When it is absolutely impossible to settle doubts by the rules established in the preceding articles, and the doubts refer to incidental circumstances of a gratuitous contract, the least transmission of rights and interests shall prevail. If the contract is onerous, the doubt shall be settled in favor of the greatest reciprocity of interests;” and

“Art. 1462. The goods which form the subject of a contract of sale may be either existing goods, owned or possessed by the seller, or goods to be manufactured, raised, or acquired by the seller after the perfection of the contract of sale, in this Title called “future goods.

There may be a contract of sale of goods, whose acquisition by the seller depends upon a contingency which may or may not happen.”

While the government may have permitted advanced payment, thus, pushing the entire contract out of the ambit of the evil avoided in Section 88 of Presidential Decree No. 1554 or the Government Auditing Code of the Philippines,⁷ it could not have contemplated to procure “future goods.”⁸ It would be hardly believable that it was the intention of the government to finance the production or manufacture of the spare parts at the outset and pay for resulting deliveries.

First, the contract is clear as to the object of the contract. The supplier undertakes to supply spare parts, tools and associated equipment for the Combat Vehicle Reconnaissance (tracked) (CVR (T)) to the AFP. Nothing in the agreement would reveal any intention by the AFP to pay for the manufacture or production of the spare parts. The terms of the contract cannot be stretched beyond reasonable construction. In other words, what has been contemplated by the AFP to be purchased were “existing goods;” and

Second, the government could not have wanted to put the perfection and validity of the contract under suspensive condition. If it were true that the down payment was intended to finance the production or manufacture of the spare parts, then, the objects of the contract effectively are placed under the legal contemplation of “future goods.” Parenthetically,

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.

⁸ See Article 1462 of the New Civil Code on the law of Sales.

without their delivery at the appointed time, the sale is not valid.⁹ To be emphatic, the government could not have meant to subject the contract to such conditions. Otherwise, it offered itself at the mercies of the supplier.

Under Article 1378 of the New Civil Code, when it is absolutely impossible to settle doubts in the interpretation of contracts by any other rules established in the Civil Code, and the contract is onerous, the doubt shall be settled in favor of the greatest reciprocity of interests. The foregoing provision of law creates a prescription by which the interests of the parties are promoted and a mechanism to ensure that the contractual relationship is achieved on equal planes.

In the case under consideration, another draw down from the renewed letter of credit even before the initial (down) payment is exhausted would place the government in a disadvantageous position as such grant would, in effect, require the government to tender payment for undelivered goods and supplies. Reciprocity of interests, in this case, should mean fairness in mutual dealings between the parties. The government should not be situated in such manner as would require it to pay for goods and supplies that have yet to be delivered. Otherwise, he is being made to pay merely for expectancy, which definitely could not have been the intention of the government in entering into a contract for procurement.

In *Legarda Hermanos vs. Saldana*¹⁰ and *Calasanz vs. Angeles*¹¹, involving the contracts of sale, the Supreme Court equitably allocated the benefits and losses between the parties to preclude undue enrichment by one at the expense of the other. Using the same norm, a draw down from the L/C before the initial draw down shall have been exhausted would prove to be prejudicial to the interests of the government. It would amount to an undue enrichment of the supplier at the government's expense. Benefits and losses that may spring from the contract should weigh equally on both parties, otherwise, the scales of fairness unfairly tilts in favor of the supplier.

Conclusion

With the foregoing elucidations, it is the opinion of the GPPB that the down payment should first be exhausted before any additional draw downs from the L/C may be had. Assuming that the government indeed intended the thirty percent (30%) down payment to finance the manufacture or production of the spare parts, any further threat to its interests should be struck down. It should not be made to pay further for goods that are undelivered.

Please bear in mind that this opinion is rendered on the basis of the facts and particular circumstances as represented. If upon further study or investigation, it would be disclosed that the facts are different from the aforementioned representations and assumptions, then, this opinion becomes inapplicable.

⁹ Pineda, E., Sales and Other Special Contracts, 2002 Ed. P. 24.

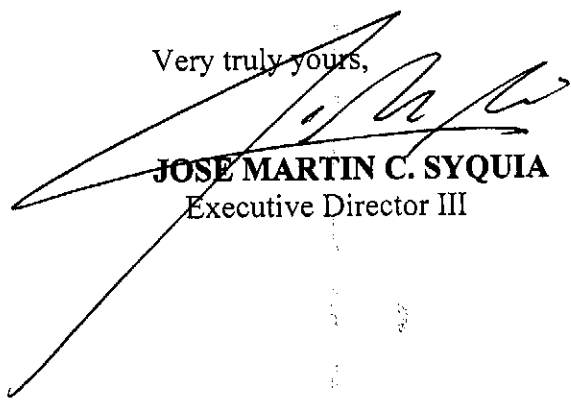
¹⁰ 55 SCRA 328.

¹¹ 135 SCRA 323.

It is well to note that the issue, including opinions and statutory provisions cited in upholding the interest and advantage of the government, supportive of the twice rendered GPPB opinion, are to be used as basis for the crafting of definitive guidelines that will govern application of advance payments for future transactions.

We trust that this clarifies matters.

Very truly yours,



JOSE MARTIN C. SYQUIA
Executive Director III

Cc:

HON. CONTANCIA P. DE GUZMAN, MNSA, Ph.D.
Undersecretary for Internal Control
Department of National Defense

REGISTRY RECEIPT

941

Post Office _____
Registered _____
Package No. _____
MALACANANG POST OFFICE
Registered on MALACANANG
RESERVE THIS RECEIPT FOR REFERENCE IN CASE OF INQUIRY
NO. SEP 0 2004
Postmaster/Teller _____