

COMMENT:

**TREATIES, CHINESE “TIED LOANS”, GOVERNMENT
PROCUREMENT AND GOOD GOVERNANCE***

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The Philippines recently witnessed a scandal that rocked the very foundations of its constitutional democracy. Two whistle blowers, Joey de Venecia, son of former Speaker Jose de Venecia, and Rodolfo “Jun” Lozada, a minor functionary of a little heard government office, the Philippine Forest Corporation, exposed “the mother of all government scams”.

Together, de Venecia and Lozada described how a US\$328 million contract for the creation of a national broadband network was anomalously awarded to the ZTE Corporation of China, saying that under-the-table payoffs were responsible for bloating the contract price to more than double the actual cost. Kristie Kenney, American Ambassador to the Philippines, declared that scandals like the NBN-ZTE contract could have been avoided had government procurement undergone a transparent process of an open, public and competitive bidding.¹

The details provided by de Venecia and Lozada were so lurid that at one point, political pundits were sure that it would lead to the ouster of President Arroyo. Lending color to the controversy was the fact that no less than the Presidential First Husband was personally interested in the contract, as evidenced by the fact that he warned de Venecia to “back off”.² In the preliminary hearing of an impeachment complaint, the former Speaker delivered a bombshell when he confirmed that he was invited by the President and her Spouse to go to the premises of the ZTE Corporation in

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¹ See Volt Contreras, *Case filed vs DOTC Chief over broadband deal*, PHIL. DAILY INQUIRER, Aug. 29, 2007, available at <http://www.inquirer.net/specialreports/nbndeal/view.php?db=1&article=20070829-85271>.

² See Dona Pazzibugan & Gil Cabacungan Jr., *Mike Arroyo is mystery man*, PHIL. DAILY INQUIRER, Sep. 19, 2007, available at http://newsinfo.inquirer.net/breakingnews/nation/view_article.php?article_id=89399.

Shenzhen, China, to play a round of golf and to partake of the famous Shanghai crabs. The Speaker would later ask: What was the President doing in the premises of a company that was interested in supplying a multi-million dollar project to the Philippine government? What was the President's husband doing in the premises of that Company? What was the Chairman of the Elections Commission doing in the same premises? What and why was he himself invited there?³

According to the Speaker, the Philippines originally planned to lay a National Broadband Network (NBN) on a Build Operate Transfer (BOT) scheme where the government will not have to pay even a single centavo for the project. Under these terms, the Speaker's son, Joey, through the US-based Amsterdam Holdings company, made a proposal to build this NBN. In his statement before the House of Representatives, the Speaker then claimed that the fateful meeting on the golfing green changed the NBN scheme from a BOT to a government-to-government transaction. Under this revised scheme, the People's Republic of China would finance the building of this network for the sum of 380 Million dollars under a loan payable with an interest of 3% per annum. In turn, because it was going to be a "tied loan", or one financed by the Chinese Exim-Bank, the Chinese would now have the prerogative to designate the project contractor, which in this case, was the ZTE Corporation.

The drama behind the ZTE scandal was in large part due to the fact that the one of the whistle blowers who set the stage had intimate knowledge of the schemes and stratagems behind the project. Rodolfo "Jun" Lozada was a close confidant of, Romulo Neri, the Director-General of the National Economic Development Authority (NEDA), the agency tasked with reviewing the financial and economic viability of projects undertaken by the Philippine government. Professor Cielito Habito, a former NEDA Director General, described the agency in this wise:

"A Nosy Agency

The NEDA is actually two things. It is the NEDA Board, chaired by the President and composed of most members of the Cabinet plus the Bangko Sentral governor, which meets once a month in lieu of the regular Cabinet meeting. It is also the NEDA Secretariat--the agency housed in Pasig City formerly headed by Neri, along with its

³ See Juliet Labog-Javellana, *JDV details secret Arroyo-ZTE meeting*, PHIL. DAILY INQUIRER, Nov. 23, 2008, available at <http://www.inquirer.net/specialreports/nbndeal/view.php?db=1&article=20081123-173809>; See Leila Salaverria & Gil Cabacungan Jr., *De Venecia: 'Arroyo bribes total P100M'*, PHIL. DAILY INQUIRER, Nov. 25, 2008, available at <http://www.inquirer.net/specialfeatures/2ndimpeachment/view.php?db=1&article=20081125-174171>.

regional offices all around the country, which provides technical secretariat support to the NEDA Board. The Neda's legal charter describes it as the highest policy-making body in the country. Thus, it cannot be as weak as it seemed to have been implied in some parts of last week's hearings.

It is the NEDA Secretariat's job to ensure that all decisions of the NEDA Board are implemented. To do this effectively, it must have the authority for oversight--that is precisely the reason for the agency's name--and as I often describe it, NEDA must necessarily "poke its nose into everybody else's business." That is why the NEDA and its director general can be so unpopular, and would rather be bypassed by Cabinet colleagues, local executives and legislators if they can.

Projects vs. Contracts

This is particularly so in the context of Neda's role in the evaluation and approval of ODA (expand) projects by the Investment Coordination Committee (ICC), prior to elevation to the full NEDA Board. The ICC, while chaired by the secretary of finance, relies on the full complement of the NEDA staff, including its regional offices, for its technical secretariat support. ODA-funded projects must thus undergo NEDA scrutiny.

On this, Neri repeatedly asserts that it is the projects' substance (he used the word "concept," which is too weak a word)--not the specific contracts--that the ICC and NEDA Board approve. But he is not completely right to insist that in the case of the NBN project, the DOTC "could do whatever it liked" in deciding how to implement it. Section 9 of the ODA Law (R.A. 8182) states: "All concerned implementing and oversight agencies shall submit to the NEDA all information and reports as may be required by it to review draft contracts (emphasis mine)."⁴

It was in this capacity that he acquired personal knowledge of the greed of high-ranking officials in the Arroyo administration, including that of the First Gentleman. According to him, his job was "to moderate their greed."⁵

⁴See Cielito Habito, *NEDA, ODA, NBN and ZTE*, PHIL. DAILY INQUIRER, Sep. 30, 2007, available at <http://inquirer.net/specialreports/nbndeal/view.php?db=1&article=20070930-91652>. See also NEDA Functions and Organizations, available at http://www.neda.gov.ph/about/functions_and_organization.htm#IAC.

⁵See Nikko Dizon, *'Moderate their greed' Instruction refers to Mike Arroyo, Abalos*, PHIL. DAILY INQUIRER, Feb. 8, 2008, available at <http://newsinfo.inquirer.net/inquirerheadlines/nation/view/20080208-117484/Moderate-their-greed>.

The sense of melodrama was even heightened when Lozada was forcibly taken from the airport upon his return to the country.⁶ Lozada and his family believed that his abductors would have killed him had there not been a vigilant media that widely broadcasted news of his abduction.

In the meantime, critics of the contract began speaking up. The University of the Philippines School of Economics issued a study that concluded that investment in an NBN network was not economically and technically feasible because the government had neither capital nor technical know-how to adapt to fast developing technological advancements.⁷ To quote the said study:

It is typical of “network economies”, of which ICT backbones are an instance, that the unit-cost of service falls with increasing capacity-utilization (measured, say by number of users). This is because fixed costs are high while variable costs are low. As already noted, there are now already two operational backbones, both privately-owned and -run.

Increasing these to three (and possibly four) would saddle the entire industry with excess capacity that was entirely of the government’s making. Once implemented, the expanded NBN would steer demand away from private backbones and effectively raise the cost for all users. Even if half of government demand hives off from private providers towards the cheaper government backbone, costs become higher for the telcos’ private customers, including business. Ironically one of those to suffer would be government itself. For it is virtually certain that government agencies will nonetheless continue to spend the rest of their telecommunications budgets (e.g., half of their spending on landline calls and 92 percent of their cell-phone expenses) on the private telcos’ services. Therefore they too become affected by higher costs. Hence it is not even entirely assured that total government telecoms costs will even be reduced.

Anticipating congestion

⁶See Dennis Gadil, *ZTE witness 'abducted' at airport*, MALAYA, Feb. 6, 2008, available at <http://www.malaya.com.ph/feb06/news1.htm>. See also Alcuin Papa, Christine Avendaño & Tarra Quismundo, *PNP: We are protecting Lozada at kin's request*, PHIL. DAILY INQUIRER, Feb. 7, 2008, available at <http://newsinfo.inquirer.net/breakingnews/nation/view/20080207-117260/PNP-We-are-protecting-Lozada-at-kins-request>; Leila Salaverria & Juliet Labog-Javellana, *Lozada's wife runs to SC for help*, PHIL. DAILY INQUIRER, Feb. 7, 2008, available at <http://newsinfo.inquirer.net/inquirerheadlines/metro/view/20080207-117261/Lozadas-wife-runs-to-SC-for-help> and *Senate takes custody of Lozada*, INQUIRER.NET, Feb. 7, 2008, available at <http://newsinfo.inquirer.net/breakingnews/nation/view/20080207-117281/Lozada-surfaces-recounts-NBN-deal-in-press-conference>.

⁷See RAUL FABELLA & EMMANUEL DE DIOS, *LACKING A BACKBONE: THE CONTROVERSY OVER THE NATIONAL BROADBAND NETWORK AND CYBER-EDUCATION PROJECTS* (2007), available at <http://www.econ.upd.edu.ph/respub/dp/pdf/DP2007-07.pdf>.

The possibility of congestion (leading to slow connections) is likely the only valid economic rationale for an extra backbone (not to mention two), and possibly some allowance for redundancy in an emergency. At present, however, no congestion is in sight. Quite the contrary, current fiber-optic pipelines are hugely under-utilized, implying zero marginal cost of additional traffic.

Even assuming the point of congestion is reached, however, there is no reason to doubt that private telcos would scramble quickly enough to absorb excess demand, as they did upon inter-connecting the country under competitive pressure. To be sure, there will remain missionary areas that remain unconnected.

But can government do the job better on its own?

Concentrating on government's core competence

From the 1990s up to until recently, the government seems to have adhered to the concept of "core competence", which implies progressively outsourcing all non-core needs to those who specialize in such non-core needs. Government agencies that have followed this formula have realized good savings. Private concessionaires now run canteens in state offices. Property security is now contracted out. Government has left (or is leaving) to the private sector the task of direct services-provision in power-generation and transmission, airlines, telephony, tollways construction, and all sorts of industrial ventures. In the meantime, government concentrates on its more important regulatory task of preserving competition; then rather than bother to run a single firm, it comes to influence the entire sector. This strategy has clearly yielded more success than the previous one: the most iconic is the outsourcing of water distribution services themselves to private concessionaires in Metro Manila.

But the loan-powered versions of NBN and CEP require the government to abandon this painfully-won strategy and resurrects the zombie of a government-run communications system (recall *Telepono sa Barangay!*). Can this be sound?

Preserving flexibility and keeping pace with technical change

The ICT sector is characterized by extremely rapid technological change. Competitive market pressures will typically prod firms to invest in cutting-edge technology. But it is precisely such competitive pressures that are suspended in a government-owned facility.

Hence there is real danger that the expanded NBN, particularly its last-mile segment, will be saddled with increasingly obsolete technology that government users themselves will progressively shun in favor of market providers. Alternatively, if government makes the use of the NBN compulsory in order to validate its past mistakes, e-

Government program could shrivel from sheer inefficiency. This is one lesson the former USSR failed to learn and which hastened its demise.

The pace of technological advance is admittedly different for various segments of the ICT sector. It is probably least rapid in the backbone segment, where the best opinion still considers optic fiber the gold standard and obsolescence may come only slowly. It is probably more rapid in the (wireless) last mile distribution segment of the network. At any rate, once NBN is on stream, government agencies will be largely wedded to a state provider from which they cannot readily shift. “Unfree to fail” government or quasigovernment entities have little regard for quality of service. Nor is there an incentive for technological change. The specter of “old PLDT” monopoly and its associated abominations loom very large. A good idea of how it will be run is provided by the career of Telof itself. Here the “soft budget constraint” rules, and deficits and state subsidies are almost inevitable. Government ends up paying higher for low quality service. To reiterate, flexibility, or the capacity to switch suppliers is an enormous competitive advantage. The government is vast, its needs myriads and constantly changing. The mismatch between demand and supply is the inevitable of central procurement.

The study concluded that by the time the network is installed, the technology would already be obsolete. It was further opined that the NBN should be left to the hands of private sector players who already had existing networks. Former Department of Transportation and Industry Secretary Josefina Lichauco also stated that the NBN project was contrary to existing legislative policies enshrined in the telecoms law and the e-commerce act that recognized that investments in the telecoms industry should be led by the private sector.⁸ Lawyers also objected to the NBN –ZTE Contract on the ground that it did not comply with the mandatory public and competitive bidding as required by Republic Act No. 9184 (R.A 9184) or the country’s government procurement law.⁹ The fact that the project did not have the prior concurrence of the Monetary Board despite the constitutional provision requiring such in cases where the country’s foreign indebtedness is increased also became an issue. Finally, the contract was also objected to on the ground that it had no certificate of availability of funds which according to the Government Auditing Code made the contract “null and void”.¹⁰

⁸ See Jo. Florendo Lontoc, *NBN, CyberEd projects lack economic sense, legal basis, and transparency – critics*, U.P. NEWSLETTER, available at <http://www.up.edu.ph/upnewsletter.php?i=518&archive=yes&yr=2007&mn=9>.

⁹ Section 10 explicitly provides the “All procurement shall be done through Competitive bidding except as provided for in Article XVI of this Act.” Article XVI lists the alternative methods of procurement.

¹⁰ See University of the Philippines Center for Integrative and Development Studies, *China as an Emergent Global Power*, Nov. 26, 2008 Proceedings.

The NBN-ZTE is not the first controversy involving a Chinese funded project. Four years earlier, the President issued Executive Order Number (E.O.) 464, which forbade members of the executive branch of government from appearing before Senate investigations.¹¹ The E.O. was issued because of a hearing that was being conducted by the Senate on the so-called Northrail project. This project concerned a 32-km railroad that was to be financed by the Chinese Exim-Bank for US\$603 million.

Prior to the scheduled public hearing of the Northrail project in the Senate, then Senate President Franklin Drilon requested a legal opinion from the UP Law Center. The latter concluded that the project was “legally infirm”.¹² The UP Law Center based its opinion on the lack of public and competitive bidding as required by R.A. 9184. At the time, the Executive department’s justification was that the Northrail contracts, consisting of a Supply Agreement and a Loan Agreement, are “Executive Agreements” which are exempt from the provisions of R.A. 9184. Eerily, the government's defense of the NBN-ZTE contract is along the same lines. The UP Law Center, on the basis of the opinions of three of its specialists in the field of International Law, belied this on the basis of a literal reading of the definition of a treaty, international agreement or an executive agreement under the Vienna Convention on the Law of Treaties (VCLOT). There, the definition of a treaty is a “written agreement entered into by sovereign states and governed by international law”. The UP Law Center study then declared that the two contracts comprising the Northrail projects were not executive agreements because they were entered into by Government-Owned and/or -Controlled Corporations (GOCC’s) and not sovereign states and that they were governed by domestic law, to wit; Philippine laws for the supply agreement and Chinese law for the loan agreement.

Like later criticisms leveled against the NBN-ZTE contract, the UP Law Center study concluded that Northrail was infirmed for the further reasons that there was no prior Monetary Board concurrence and no certificate of availability of funds contrary to the provisions of the Government Auditing Code. The Center also specifically identified provisions that it claimed were grossly disadvantageous to government. Some of these were provisions in the loan agreement included one that

¹¹ See Senate of the Philippines vs. Exec. Sec., G.R. No. 169777, 488 SCRA 1, Apr. 20, 2006, *available at* <http://www.supremecourt.gov.ph/DECISION%20EO%20464%20Final.htm>.

¹² See LEGAL, ECONOMIC, FINANCIAL AND TECHNICAL OPINION ON THE: (1) CONTRACT BETWEEN NORTH LUZON RAILWAYS CORPORATION AND CHINA MACHINERY AND EQUIPMENT CORPORATION; AND (2) BUYER CREDIT LOAN AGREEMENT No. BLA 4055 DATED 26 FEBRUARY 2004 BETWEEN THE EXPORT IMPORT BANK OF CHINA AND THE GOVERNMENT OF THE REPUBLIC OF THE PHILIPPINES [hereinafter UP LAW CENTER STUDY] *available at* <http://pcij.org/blog/wp-docs/up-study-northrail.pdf>.

surrendered the Republic of the Philippines's immunity from suit and enforcement in the event of non-payment of the loan. Another such provision allowed the Chinese Exim-Bank to directly release loan proceeds to the Chinese contractor without need of the funds to enter first into the national coffers.

The Commission on Audit would repeat these exact observations four years later in its 2007 annual report on Northrail Inc.¹³ To quote the pertinent portions of the report:

5. Supply Contract Agreement entered into by and between Northrail and China National Machinery and Equipment Corporation (Group) (CNMEG) and the Buyer's Credit Loan Agreement (BCLA) between the DOF- RP and China EXIM Bank

In December 2003, the NEDA Board and the NEDA – Investment Coordinating Council approved Phase 1, Section 1 of the Northrail Project covering the alignment from Caloocan City to Malolos, Bulacan. The NEDA-Regional Development Council (RDC) III also endorsed the Project under its Resolution No. 03-96-2003. On December 30, 2003, a Supply Contract Agreement with CNMEG was executed, which became effective on July 23, 2004 after all the conditions precedent to the effectivity of the said agreement were complied with.

To finance the project, a US\$400 million Buyer's Credit Loan Agreement between the DOF-RP (Borrower) and China EXIM Bank (Lender) was executed on February 26, 2004. As provided in the BCLA, the Lender agrees to make available a loan facility to the Borrower in an aggregate principal amount not exceeding US\$400 million or 95% of the Contract Price for the purpose of financing the construction of the Northrail Project. The remaining 5% or US\$21.05 million shall be the Philippine counterpart. The term of the agreement is 20 years from the date of Notice of Approval of Contract to the Final Repayment Date with an interest rate of 3% per annum. The loan agreement also provides that the Borrower shall pay to the Lender a Management Fee of 0.2% of the Facility which is equivalent to US\$800,000 within 60 days from the date of the Agreement and a Commitment Fee of 0.2% per annum on the daily unutilized portion of the Facility.

¹³ See COMMISSION ON AUDIT 2007 Audited Annual Reports Government Owned and Controlled Corporations Cluster IV Industrial & Area Development And Regulatory North Luzon Railways Corporation available at <http://www.coa.gov.ph/Audit/AAR.htm>.

Review of the abovementioned Supply Contract Agreement disclosed the following observations:

- a) The contract was granted to CNMEG without the benefit of a public bidding.
- b) One of the requirements for the release of the first drawdown by China EXIM Bank is the release by Northrail of the 5% down payment for the CNMEG. Aside from the 5% down payment released to CNMEG, advance payment equivalent to 25% of the contract price was also provided in the Supply Contract Agreement under Sec. 11.2 for the cost of preparation, mobilization, relocation, etc. The advance payment shall include the amount of \$27.540 million for the ROW expenses and Public Utilities Diversion which shall be borne by CNMEG, but the actual works, relocation and diversion shall be the responsibilities of Northrail.
- c) No surety bond, bank guarantee or irrevocable standby letter of credit of equivalent value was posted by CNMEG for the advance payment although they submitted a performance bank guarantee corresponding to 10% of Contract Price for the down payment.
- d) No Certificate of Availability of Funds was issued prior to signing of the contract.
- e) All taxes, duties and other charges levied by the Government of the Philippines shall be borne by Northrail (Sec. 7.1)
- f) The contract agreement with CNMEG includes design. However, said design has not been prepared and submitted before the implementation of the contract agreement, hence, said provision may be considered disadvantageous since Northrail is deprived of the option to determine whether the design conforms with the requirement of Northrail vis-à-vis the contract cost.

With regard to the Buyer Credit Loan Agreement, the following provisions appear to be disadvantageous to the Philippine government:

- a) Sec. 9.1, Art. 9 The “no tax deductions” clause appears disadvantageous to the Government of the Republic of the Philippines as it prevents the imposition of taxes or charges that may be required by law.
- b) Sec. 11.2 (j), Art. 11 The provision which cancels the right to immunity or other such privilege (sovereign or otherwise) of the Borrower and its assets is grossly adverse to the Government of the Republic of the Philippines and may violate constitutional or statutory provisions on immunity.
- c) Sec. 11.2 (k), Art. 11 Same comments as that of Section 11.2(j). This submission to the laws of the PROC may be contrary to the Philippine laws, particularly since the PROC, a communist state, has a different legal system.
- d) Sec. 15.1, Art 15 The governing law of PROC, submission to its courts and waiver of immunity are disadvantageous to the Government of the Republic of the Philippines as commented above.
 15.3, Art. 15
 15.4, Art. 15
 15.5, Art 15
- e) Sec. 17.1, Art. 17 The assignment of rights by the Borrower requires the prior written consent of the Lender but the assignment of rights by the Lender requires a mere notice to the Borrower. This is partial to the PROC.

We have also noted the following:

I. Supply Contract Agreement between Northrail and CNMEG dated December 2003 preceded the Buyer’s Credit Loan Agreement dated February 26, 2004

II. “Tied loan” which requires China EXIM Bank to nominate the contractor for the project to be financed by the loan is illegal because it is not among the alternative methods of procurement as enumerated under Sec. 48 of RA 9184.

III. The amount of US\$421 million is a loan to the Republic of the Philippines and after the loan contract has been concluded, the amount should have been deposited to the account of the Republic of the Philippines.

IV. Additional 1% will be charged to the project by the Philippine Government through the DOF as provided under the subsidiary loan agreement between the Government of the Republic of the Philippines and Northrail for the Export-Import Bank of China Loan for the Northrail Project, Phase 1, Section 1.

We recommended that Management explain/justify why these provisions/observations in the Supply Contract Agreement and Buyer's Credit Loan Agreement should not be considered disadvantageous to the government."¹⁴

At the core of the twin Chinese Exim-Bank controversies is the insistence of both the Chinese government and the Arroyo administration that since these are "tied loans", these agreements are exempt from public bidding requirements as required by law.¹⁵ Said provision reads:

Section 4. Scope and Application. - This act shall apply to the Procurement of Infrastructure Projects, Goods and Consulting Services, regardless of source of funds, whether local or foreign, by all branches and instrumentalities of government, its departments, offices and agencies, including government-owned and/or-controlled corporations and local government units, subject to the provisions of Commonwealth Act No. 138. Any treaty or international or executive agreement affecting the subject matter of this Act to which the Philippine government is signatory shall be observed.

The Executive Branch has also argued that in addition to being "tied loans", contracts entered into with political organs of a Socialist state are "executive agreements" and hence, exempt from bidding. To quote the pertinent portions of the Opinion of the Secretary of Justice on the matter:

In several instances, this Department had the occasion to rule that commercial agreements concerning loans, guarantees or other credit accommodations are in the nature of an executive agreement because they embody arrangements of a more or less temporary nature; that is, they become *functus officio* upon settlement of the obligors' liabilities.

¹⁴ *Id.*

¹⁵ *See* note 9.

Thus, in *Opinion No. 102, series of 2004*, involving a project covered by a Loan Agreement with the Japan Bank for International Cooperation (JBIC), this Department ruled:

. . . Considering that the subject matter of the original Loan Agreement involves agreements of a more or less temporary nature, the said Agreement is deemed an executive agreement, not a treaty, under international law.

In *Opinion No. 17, series of 2005*, the request for opinion involves the Philippine Rural Electrification Service (PRES) Project which was (1) approved for funding by the French Government in a Loan Agreement entered into by and between the Government of the French Republic and the Government of the Republic of the Philippines and (2) covered under the Memorandum of Undertaking (MOU) executed by and between the Department of Energy (DOE) and National Power Corporation (NPC), on one part, and the Consortium of Paris Manila Technology Corporation (PAMATEC) and ETDE of Bouygues Construction (the "Consortium"), on the other. The Department ruled in this case that the requirement of the law on public bidding does not apply to the PRES Project because it is governed by an international or executive agreement. To support our opinion, we cited, in particular, (1) the Loan Agreement which provides, as a condition, that the fund shall be used to purchase in France French goods and services and (2) the letter of the French Ambassador to the Philippines which states, among others, that the Consortium, which will undertake the Project, had been rigorously assessed and evaluated by a French Government expert.

We note that, unlike the facts involved in the foregoing opinions of this Department, the proposed NBN Project subject of the instant opinion is not yet covered by any loan agreement between the Government of the Republic of the Philippines and Government of the People's Republic of China.

To buttress the importance of a loan agreement in the determination of whether or not a certain project is covered by an executive agreement, we point that the document denominated as "Exchange of Notes" in the case of *Abaya v. Ebdane*, which was invoked by your Department to support your aforesaid view on the matter, contains the salient terms and conditions of the loan to be extended by the Government of Japan to the Government of the Republic of the Philippines.

Moreover, the Supreme Court in *Abaya* ruled that the subsequent Loan Agreement that was entered into between the Government of the Republic of the Philippines and the Japan Bank of International Cooperation (JBIC) forms part of the Exchange of Notes and cannot be properly taken independent thereof, thus:

Loan Agreement No. PH-P204 was subsequently executed and it declared that it was so entered by the parties "[i]n the light of the contents of the Exchange of Notes between the Government of Japan and the Government of the Republic of the Philippines dated December 27, 1999, concerning Japanese loans to be extended with a view to promoting the economic stabilization and development efforts of the Republic of the Philippines." Under the circumstances, the JBIC may well be considered an adjunct of the Japanese Government. Further Loan Agreement No. PH-P204 is indubitably an integral part of the Exchange of Notes. It forms part of the Exchange of Notes such that it cannot be properly taken independent thereof. (emphasis ours)

In effect, therefore, it is the ruling in *Abaya v. Ebdane* that the Exchange of Notes, which was considered by the Supreme Court as an executive agreement, includes, as an integral part thereof, the Loan Agreement between the JBIC and the Government of the Republic of the Philippines.

In this connection, it is this Department's opinion that the exchange of correspondence between Presidential Chief of Staff Michael Defensor and Chinese Minister of Commerce Bo XiLai/Chinese Ambassador Li Jinjun may be considered as an executive agreement, provided that, the Loan Agreement between the Government of the Republic of the Philippines and the China Exim Bank is subsequently concluded, considering that said loan agreement is considered an integral part of the executive agreement with the Government of the People's Republic of China.

To be sure, as ruled by the Supreme Court in *Abaya v. Ebdane*, an exchange of notes is considered a form of an executive agreement, which becomes binding through executive action without need of a vote by the Senate and that like treaties and conventions, it is an international instrument binding at international law.

The second issue involves an examination of the coverage of Republic Act No. 9184, otherwise known as the "Government Procurement Reform Act". Section 4 of the said Act provides that it shall apply to:

. . . the Procurement of Infrastructure Projects, Goods and Consulting Services, regardless of source of funds, whether local or foreign, by all branches and instrumentalities of government, its departments, offices and agencies, including government-owned and/or -controlled corporations and local government units, subject to the provisions of Commonwealth Act No. 138. Any treaty or international or executive agreement affecting the subject matter of

this Act to which the Philippine government is a signatory shall be observed. (emphasis ours)

Clearly, therefore, executive agreements involving infrastructure projects to be funded by a foreign lending institution do not fall within the scope of R.A. No. 9184 which mandates that all procurement activities must be made through public bidding.

In the present case, no public bidding is required because based on the exchange of correspondence between Chinese Ambassador Li Jinjun and Presidential Chief of Staff Michael Defensor, the Chinese Government has designated ZTE Corporation as the project's prime contractor, thus:

It may interest Your Honorable to know that ZTE Corporation, a reputable and established telecommunications Company in China, responded to this worthwhile undertaking and, consequently, the People's Republic of China through the Chinese Ministry of Commerce designated it as the NBN project's prime contractor.

Moreover, Chinese Ambassador Li Jinjun also confirmed in the said exchange of correspondence that the NBN Project will be funded by the Chinese Government through the China Exim Bank, thus:

. . . Instructed by Chinese government, I would like to inform you and the Philippine Government that we intend to support your priority initiative, the NBN Project and agree to provide preferential buyer's credit financing support through the China Exim Bank.

In *Opinion No. 102, series of 2004*, this Department adopted the comments of the Government Procurement Policy Board (GPPB) and ruled that since R.A. No. 9184 has yet no implementing rules and regulations on procurement activities that are foreign-funded (to be called "Implementing Rules and Regulations Part B" or "IRR-B"), 5 said foreign-funded procurement activities may be conducted following the guidelines set by the foreign lending institution concerned in the loan agreement. The reason for this is that although R.A. No. 9184 covers all types of government procurement regardless of source of funds, Section 4 thereof recognizes the Government's international commitments and obligations in requiring that any treaty or international or executive agreement shall be observed, in accordance with the international law principle of *pacta sunt servanda*. The only exception to this, according to the GPPB, is if the subject loan agreement is silent as to the governing guidelines, the provisions of the Implementing Rules and Regulations Part A (IRR-A) of R.A. No. 9184 covering domestically-funded procurement activities may apply.

Thus, since, as represented by your Department, the NBN Project will be funded by a foreign lending institution, specifically, the China Exim Bank, the guidelines of said bank on procurement shall be followed, unless the loan agreement with said bank is silent as to the governing guidelines. In which case, the IRR-A of R.A. No. 9184 may apply.

In sum, it is the opinion of this Department that: (1) the exchange of correspondence between Presidential Chief of Staff Michael Defensor and Chinese Minister of Commerce Bo XiLai/Chinese Ambassador Li Jinjun may be considered as an executive agreement pursuant to the case of *Abaya v. Ebdane*, provided that, the Loan Agreement between the Government of the Republic of the Philippines and the China Exim Bank is subsequently concluded, (2) the designation of ZTE Corporation as the project's prime contractor in the exchange of notes has to be observed pursuant to Section 4 of R.A. No. 9184 and the principle of *pacta sunt servanda*; and (3) the guidelines of the foreign lending institution, which in this case is the China Exim Bank, on procurement shall be followed, unless the loan agreement with said institution is silent as to the governing guidelines; in which case, the IRR-A of R.A. No. 9184 may apply.”¹⁶ (citations omitted)

But apart from the thorny issue of the definition of an “Executive Agreement”, a further issue would be whether or not the last sentence of Section 4 of R.A. 9184 may be construed to mean that all treaties, international or executive agreements are excluded from the coverage of the law, if in fact they are altogether excluded. To reiterate a treaty is:

[A]n international agreement concluded between States in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments and whatever its particular designation.¹⁷

Since the law itself mentions “treaties”, the first step in resolving the issue of whether or not Chinese “tied loans” are exempt from public and competitive bidding lies in the definition of a treaty as provided by the VCLOT, and as has been incorporated into Philippine Law.

In the case of *Bayan*,¹⁸ the issue submitted before the court concerned the constitutionality of the Visiting Forces Agreement (VFA).

¹⁶ DEPARTMENT OF JUSTICE Opinion No. 46 series of 2007 dated July 26, 2007.

¹⁷ Vienna Convention on the Law of Treaties, May 23 1969, 1155 U.N.T.S. 331. Entered into force Jan. 27, 1980.

¹⁸ *Bayan v. Exec. Sec.*, G.R. No. 138570, 342 SCRA 449, Oct. 10, 2000.

The express language of the 1987 constitution provides that upon expiration of the US-Philippine Bases Agreement, no foreign troops or bases shall be allowed in the territory of the country unless pursuant to a treaty duly recognized by the contracting parties as such. The drafting history of this provision will show that what the provision intended to avoid was the anomaly under the 1954 bases agreement wherein the Philippine Senate alone gave its concurrence to the Treaty while its US counterpart did not. Petitioners impugned the constitutionality of the VFA since the US Senate again failed to give its concurrence to the same.

In determining whether the concurrence of the US Senate was required, the Supreme Court justices first had to address the nature of the VFA itself. To begin with, the constitution provides that foreign troops would only be allowed in the Philippines pursuant to a “treaty duly recognized by the other contracting party as such.”

In ruling the VFA, was such a treaty, the court cited verbatim the definition of a Treaty under the VCLOT:

[A]n international agreement concluded between States in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments and whatever its particular designation.¹⁹

As a matter of jurisprudence, Bayan is therefore valid authority for saying that the exact same definition of a treaty as defined in the VCLOT is incorporated into Philippine law:

A treaty, as defined by the Vienna Convention on the Law of Treaties, is an international instrument concluded between States in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments, and whatever its particular designation. There are many other terms used for a treaty or international agreement, some of which are: act, protocol, agreement, *compromis d' arbitrage*, concordat, convention, declaration, exchange of notes, pact, statute, charter and *modus vivendi*. All writers, from Hugo Grotius onward, have pointed out that the names or titles of international agreements included under the general term treaty have little or no legal significance. Certain terms are useful, but they furnish little more than mere description.

¹⁹ See note 17.

Article 2(2) of the Vienna Convention provides that “the provisions of paragraph 1 regarding the use of terms in the present Convention are without prejudice to the use of those terms, or to the meanings which may be given to them in the internal law of the State.”

Thus, in international law, there is no difference between treaties and executive agreements in their binding effect upon states concerned, as long as the negotiating functionaries have remained within their powers. International law continues to make no distinction between treaties and executive agreements: they are equally binding obligations upon nations.”²⁰ (citations omitted)

The next, and probably more important issue is: whether all procurements done through a treaty, international agreement or an executive agreement are wholly exempt from the coverage of R.A. 9184.

Here, it would be instructive to look at the legislative intent of the framers of the law and a case recently decided by the Philippine Supreme Court, which ironically, was filed by the law's principal author, Rep. Plaridel Abaya of the third district of Cavite.²¹

During the Bicameral Conference deliberation of R.A. 9184, it became apparent that the only exclusions from R.A. 9184 were “Official Development Assistance” (ODAs) or projects that the government would not have to pay for:

“REP. ABAYA. Mr. Chairman, can we just propose additional amendments? Can we go back to Section 4, Mr. Chairman?”

THE CHAIRMAN (SEN. ANGARA). Section? Section ano, Del, 4? Definition ? definition of terms.

REP. ABAYA. Sa House bill, it is sa scope and application.

THE CHAIRMAN (SEN. ANGARA). Okay.

REP. ABAYA. It should read as follows: "This Act shall apply to the procurement of goods, supplies and materials, infrastructure projects and consulting services regardless of funding source whether local or foreign by the government."

THE CHAIRMAN (SEN. ANGARA). Okay, accepted. We accept. The Senate accepts it.

²⁰ See note 18.

²¹ *Abaya v. Ebdane*, G.R. No. 167919, 515 SCRA 720, Feb. 14, 2007.

x x x

THE CHAIRMAN (SEN ANGARA). Just take note of that ano. Medyo nga problematic 'yan eh. Now, just for the record Del, can you repeat again the justification for including foreign funded contracts within the scope para malinaw because the World Bank daw might raise some objection to it.

REP. ABAYA. Well, Mr. Chairman, we should include foreign funded projects kasi these are the big projects. To give an example, if you allow bids above government estimate, let's say take the case of 500 million project, included in that 500 million is the 20 percent profit. If you allow them to bid above government estimate, they will add another say 28 percent of (sic) 30 percent, 30 percent of 500 million is another 150 million. Ito, this is a rich source of graft money, aregluhan na lang, 150 million, five contractors will gather, "O eto 20 million, 20 million, 20 million." So, it is rigged. □Yun ang practice na nangyayari. If we eliminate that, if we have a ceiling then, it will not be very tempting kasi walang extra money na pwedeng ibigay sa ibang contractor. So this promote (sic) collusion among bidders, of course, with the cooperation of irresponsible officials of some agencies. So we should have a ceiling to include foreign funded projects."

In his Petition later before the Supreme Court, Rep. Abaya correlated this with the second sentence of Section 4 of R.A. 9184 arguing that this was the import of the phrase: "regardless of source of funding, whether local or foreign", that is, to emphasize that all procurements, regardless of source of funding, should comply with the provisions of the said law.

This²² was a situation wherein the principal author of the law wanted to seek judicial confirmation of the legislative intent in order to invalidate contracts that did not comply with mandatory provisions of the procurement law. Almost immediately upon the effectivity of R.A. 9184, Rep. Abaya, guided by his desire to see a level playing field between local and foreign contractors particularly on the so-called maximum price ceiling provision of the law, sought to declare a Japanese-funded project, the Catanduanes Circumferential Road as null and void because the proponent in that project submitted a bid over and above the maximum price ceiling as provided by R.A. 9184 quoted below:

²² *Id.*

Section 31. Ceiling for Bid Prices. - The ABC²³ shall be the upper limit or ceiling for the Bid prices. Bid prices that exceed this ceiling shall be disqualified outright from further participating in the bidding. There shall be no lower limit to the amount of the award.

This ceiling is a maximum price computation determined by the project proponent on how much an infrastructure project should cost. And since the computation already includes a healthy provision for a 30% return on investment for the project contractor, the law disqualified all bids above the price ceiling for the project in an effort to limit graft and corruption.

Rep. Abaya arbitrarily chose the object of his test case (*Abaya*, later on). Simply put, the Catanduanes Circumferential Road Project was chosen not only because it was one project where the foreign contractor exceeded the maximum price ceiling but also because it was the only such project that the Congressman had records of.

The choice of the project proved fatal for Rep. Abaya. While he was certain that the court would declare the project as null and void for failure to comply with section 31 of the very same law that he authored, the Court ruled that he chose the wrong project because he chose one that was bid out and awarded to its contractor prior to the effectivity of R.A. 9184. And because the law applicable was still an E.O. promulgated by then President Corazon Aquino that did not require foreign contractors to comply with the maximum price ceiling provision, the ruling was that the Petition was dismissed because R.A. 9184 was not yet the applicable law:

R.A. 9184 cannot be applied retroactively to govern the procurement process relative to the CP I project because it is well settled that a law or regulation has no retroactive application unless it expressly provides for retroactivity. Indeed, Article 4 of the Civil Code is clear on the matter: "[l]aws shall have no retroactive effect, unless the contrary is provided." In the absence of such categorical provision, R.A. 9184 will not be applied retroactively to the CP I project whose procurement process commenced even before the said law took effect.

²³ **Section 5. Definition of Terms.**- For purposes of this Act, the following terms or words and phrases shall mean or be understood as follows:

(a) Approved Budget for the Contract (ABC) - refers to the budget for the contract duly approved by the Head of the Procuring Entity, as provided for in the General Appropriations Act and/or continuing appropriations, in the National Government Agencies; the Corporate Budget for the contract approved by the governing Boards, pursuant to E.O.No.518, series of 1979, in the case of Government Financial Institutions and State Universities and Colleges; and the Budget for the contract approved by the respective Sanggunian, in the case of Local Government Units.

That the legislators did not intend RA 9184 to have retroactive effect could be gleaned from the IRR-A formulated by the Joint Congressional Oversight Committee (composed of the Chairman of the Senate Committee on Constitutional Amendments and Revision of Laws, and two members thereof appointed by the Senate President and the Chairman of the House Committee on Appropriations, and two members thereof appointed by the Speaker of the House of Representatives) and the Government Procurement Policy Board (GPPB). Section 77 of the IRR-A states, thus:

SEC. 77. Transitory Clause

In all procurement activities, if the advertisement or invitation for bids was issued prior to the effectivity of the Act, the provisions of E.O. 40 and its IRR, P.D. 1594 and its IRR, R.A. 7160 and its IRR, or other applicable laws, as the case may be, shall govern.

In cases where the advertisements or invitations for bids were issued after the effectivity of the Act but before the effectivity of this IRR-A, procuring entities may continue adopting the procurement procedures, rules and regulations provided in E.O. 40 and its IRR, P.D. 1594 and its IRR, R.A. 7160 and its IRR, or other applicable laws, as the case may be.

In other words, under IRR-A, if the advertisement of the invitation for bids was issued prior to the effectivity of R.A. 9184, such as in the case of the CP I project, the provisions of E.O. 40 and its IRR, and P.D. 1594 and its IRR in the case of national government agencies, and R.A. 7160 and its IRR in the case of local government units, shall govern.

Admittedly, IRR-A covers only fully domestically-funded procurement activities from procurement planning up to contract implementation and that it is expressly stated that IRR-B for foreign-funded procurement activities shall be subject of a subsequent issuance. Nonetheless, there is no reason why the policy behind Section 77 of IRR-A cannot be applied to foreign-funded procurement projects like the CP I project. Stated differently, the policy on the prospective or non-retroactive application of R.A. 9184 with respect to domestically-funded procurement projects cannot be any different with respect to foreign-funded procurement projects like the CP I project. It would be incongruous, even absurd, to provide for the prospective application of R.A. 9184 with respect to domestically-funded procurement projects and, on the other hand, as urged by the petitioners, apply R.A. 9184 retroactively with respect to foreign-funded procurement projects. To be sure, the lawmakers could not have intended such an absurdity.

Thus, in the light of Section 1 of E.O. 40, Section 77 of IRR-A, as well as the fundamental rule embodied in Article 4 of the Civil Code on prospectivity of laws, the Court holds that the procurement process for the implementation of the CP I project is governed by E.O. 40 and its IRR, not R.A. 9184.²⁴ (citations omitted)

By way of obiter dictum, the Court though ruled that assuming the law to already be the applicable law, still the circumferential road project was included in an exchange of note signed by the Philippine government and the Japanese government identifying the projects to be financed by the Japanese funding agency, the JBIC:

Significantly, an exchange of notes is considered a form of an executive agreement, which becomes binding through executive action without the need of a vote by the Senate or Congress. The following disquisition by Francis B. Sayre, former United States High Commissioner to the Philippines, entitled "The Constitutionality of Trade Agreement Acts," quoted in *Commissioner of Customs v. Eastern Sea Trading*, is apropos:

Agreements concluded by the President which fall short of treaties are commonly referred to as executive agreements and are no less common in our scheme of government than are the more formal instruments, treaties and conventions. They sometimes take the form of exchange of notes and at other times that of more formal documents denominated "agreements" or "protocols". The point where ordinary correspondence between this and other governments ends and agreements, whether denominated executive agreements or exchange of notes or otherwise begin, may sometimes be difficult of ready ascertainment. It would be useless to undertake to discuss here the large variety of executive agreements as such, concluded from time to time. Hundreds of executive agreements, other than those entered into under the trade-agreements act, have been negotiated with foreign governments.

x x x

The Exchange of Notes dated December 27, 1999, stated, inter alia, that the Government of Japan would extend loans to the Philippines with a view to promoting its economic stabilization and development efforts; Loan I in the amount of Y79,8651,000,000 would be extended by the JBIC to the Philippine Government to implement the projects in the List A (including the Arterial Road Links Development Project - Phase IV); and that such loan (Loan I) would be used to cover payments to be made by the Philippine executing

²⁴ See note 21.

agencies to suppliers, contractors and/or consultants of eligible source countries under such contracts as may be entered into between them for purchases of products and/or services required for the implementation of the projects enumerated in the List A.

With respect to the procurement of the goods and services for the projects, it bears reiterating that as stipulated:

3. The Government of the Republic of the Philippines will ensure that the products and/or services mentioned in sub-paragraph (1) of paragraph 3 of Part I and sub-paragraph (1) of paragraph 4 of Part II are procured in accordance with the guidelines for procurement of the Bank, which set forth, inter alia, the procedures of international tendering to be followed except where such procedures are inapplicable or inappropriate.

The JBIC Procurements Guidelines, as quoted earlier, forbids any procedure under which bids above or below a predetermined bid value assessment are automatically disqualified. Succinctly put, it absolutely prohibits the imposition of ceilings on bids.

Under the fundamental principle of international law of *pacta sunt servanda*, which is, in fact, embodied in Section 4 of R.A. 9184 as it provides that "[a]ny treaty or international or executive agreement affecting the subject matter of this Act to which the Philippine government is a signatory shall be observed," the DPWH, as the executing agency of the projects financed by Loan Agreement No. PH-P204, rightfully awarded the contract for the implementation of civil works for the CP I project to private respondent China Road & Bridge Corporation.²⁵ (citations omitted)

While the Court could have further clarified its construction of the penultimate sentence of section 4 of R.A. 9184, there was, unfortunately, no categorical statement that only treaties already in existence at the time of the effectivity of the law could be excluded from the coverage of R.A. 9184.

Shortly after the Abaya decision (Abaya) was promulgated, but before it could become final and executory²⁶, the Court had an occasion to already cite it as a legal precedent. This was in the case of *Department of Budget*

²⁵ *Id.*

²⁶ Petitioners Abaya et.al. received the Notice of Judgment on March 3, 2007. Under the provisions of Philippines Rules of Court, a Motion for Reconsideration can be filed with 15 days from receipt of notice; afterwards the judgment becomes final and executory. A Motion for Reconsideration was within the 15 day period on 22 March 2007 and a Notice denying the Motion for Reconsideration was received on 21 September 2007. The Supreme Court Entry of Judgment states that the decision became final and executory on 25 September 2007. Law and Jurisprudence dictates that only Supreme Court decisions that have become final and executory can be sighted as the correct interpretation of a legal matter.

*and Management (DBM) et. al vs. Kolonwel Trading et. al.*²⁷ This case involved an annual World Bank-funded loan of around 500 Million pesos intended to buy textbooks for grade school and high school students. While the issue there was the legality of a Notice of Award made by the Inter-Agency Bidding and Awards Committee that awarded the 2006 textbook contract to Vibal Publishing despite an earlier Resolution disqualifying the said proponent for “conflict of interest”,²⁸ the Supreme Court nonetheless included as one of the issues for resolution “which, as between the World Bank Guidelines on international Competitive Bidding and the Government Procurement Reform Act (R.A. 9184) has primacy in the conduct, performance and implementation of bidding procedures for foreign-funded procurement projects.²⁹ While the Respondent thereat argued that no such conflict exists since a “conflict of interest” is prohibited by both R.A. 9184 and World Bank Guidelines,³⁰ the Court nonetheless held:

Under the fundamental international law principle of *pacta sunt servanda*, which is in fact embodied in the afore-quoted Section 4 of R.A. No. 9184, the RP, as borrower, bound itself to perform in good faith its duties and obligation under Loan No. 7118- PH. Applying this postulate in the concrete to this case, the IABAC was legally obliged to comply with, or accord primacy to, the WB Guidelines on the conduct and implementation of the bidding/procurement process in question.³¹

How a non-state entity such as the World Bank could become a party to a treaty is open to question³². What appears even more perplexing is how the Court applied the doctrine of *Abaya* which at the time of its promulgation, was not even final and executory, but worse, was applied apparently under a wrong context:

²⁷ Dep't of Budget and Management Procurement Service (DBM-PS) v. Kolonwel Trading, G.R. No. 175608, 524 SCRA 591, Jun. 8, 2007.

²⁸ Defined under Section 65 of Rep. Act No. 9186 as: "When a bidder maliciously submits different Bids through two or more persons, corporations, partnerships or any other business entity in which he has interest to create the appearance of competition that does not in fact exist so as to be adjudged as the winning bidder.

²⁹ See note 27, Resolution dated Feb. 6, 2007, G.R. No. 175608.

³⁰ See note 27, Respondent's Memorandum, April 20, 2007, G.R. No. 175608, at 45. See Part 1 of World Bank Guidelines and Appendix 3 of World Bank Guidelines providing that the implementation of World Bank funded projects are lodged with the member country and not the Bank available at <http://siteresources.worldbank.org/INTPROCUREMENT/Resources/Procurement-May-2004.pdf>.

³¹ See note 27, at 14

³² The Vienna Convention on Diplomatic Relations Between States and International Organizations drafted by the International Law Commission sought to vest International Organizations treaty making powers. The said convention has not come into effect because only 25 states have thus far ratified it. The Convention specifies that at least 40 states must ratify before it could come into effect. For a text of the treaty, see http://untreaty.un.org/ilc/texts/instruments/english/conventions/1_2_1986.pdf.

The question as to whether or not foreign loan agreements with international financial institutions, such as Loan No. 7118-PH, partake of an executive or international agreement within the purview of the Section 4 of R.A. No. 9184, has been answered by the Court in the affirmative in *Abaya*, supra. Significantly, *Abaya* declared that the RP-JBIC loan agreement was to be of governing application over the CP I project and that the JBIC Procurement Guidelines, as stipulated in the loan agreement, shall primarily govern the procurement of goods necessary to implement the main project.³³

The criticism being made is that while the Court in *DBM*, purportedly citing *Abaya* ruled that loan agreements are in the nature of Executive agreements, *Abaya* itself is clear that what made the Catanduanes Circumferential Road Project part of an Executive Agreement was the Exchange of Notes entered into by the Philippine Government with the Japanese Ambassador identifying the projects to be financed by the JBIC that included the said project. Loan agreements, standing alone, at least pursuant to the doctrine in *Abaya*, could not qualify as “executive agreements”.

It was this context of the *Abaya* ruling that the executive would cite as a justification for the non-bidding of the NBN ZTE contract.³⁴ The public furor that ensued at the height of the Senate investigation of the NBN-ZTE contract obviously led to President Arroyo’s order canceling the project. But this was not after she herself admitted that she knew of the alleged bribery the night before she signed the said deal.³⁵ It was during her trip to the Boao Forum for Asia last April 2007 that she witnessed the signing of five economic agreements with China that included Northrail, the CyberEd, and the NBN-ZTE contract.³⁶

Through its express declarations and contemporaneous acts, the Executive has now taken the position that *Abaya* has given prospective application to Section 4 of R.A. 9184 and will hence be the legal basis to exclude any and all procurements through treaties, international agreements

³³ *Id.*

³⁴ See note 16; See also Action for Economic Reforms, A REVIEW OF THE NATIONAL BROADBAND NETWORK -ZTE SUPPLY CONTRACT Policy paper dated Oct. 19, 2007 available at http://www.aer.ph/pdf/papers/NBNSupplyContract_review.pdf, Senate Hearing dated Sep. 20, 2007, Transcript available at http://images.gmanews.tv/pdf/nbnzte/senate%20transcripts/ZTE_Senate_Transcript--09202007.pdf and Riza Olchondra & Gil Cabacungan Jr., *Nature of NBN deal debated in Senate*, PHIL. DAILY INQUIRER, Sep. 21, 2007, available at http://newsinfo.inquirer.net/inquirerheadlines/nation/view_article.php?article_id=89815.

³⁵ Dave Cagahastian, *GMA denies condoning bribery in NBN-ZTE deal*, MANILA BULLETIN, February 24, 2008 available at <http://www.articlearchives.com/law-legal-system/evidence-witnesses/163221-1.html>.

³⁶ *So much investments, so little time for PGMA in China*, available at <http://www.ops.gov.ph/boaoforum2007/news3.htm>.

and executive agreements entered into by the government.³⁷ This is erroneous given the language of section 4, that only agreements that the country "IS" a party to are covered, and the fact that had Congress intended the same to have prospective application, then it should have used words to that effect. Furthermore, this construction also runs contrary to the express coverage of the law to include any and all forms of procurement, by all branches, instrumentalities of government, including local government units and GOCCs and regardless of source of funding.

The later Suplico Petition impugning the validity of the NBN-ZTE contract also on the ground of lack of public bidding could have been the opportunity for the court to further clarify its construction of section 4.³⁸ In this case, Vice-Governor Suplico, while successful in procuring a Temporary Restraining Order which temporarily enjoined the government from implementing the NBN-ZTE project during the course of the Senate investigation, lost the case on the merit on the ground that the controversy has become moot and academic because the government has communicated to the Court its resolve to permanently shelve the project. The Court decided in this manner:

When President Gloria Macapagal-Arroyo, acting in her official capacity during the meeting held on October 2, 2007 in China, informed China's President Hu Jintao that the Philippine Government had decided not to continue with the ZTE-National Broadband Network (ZTE-NBN) Project due to several reasons and constraints, there is no doubt that all the other principal prayers in the three petitions (to annul, set aside, and enjoin the implementation of the ZTE-NBN Project) had also become moot.

Contrary to petitioners' contentions that these declarations made by officials belonging to the executive branch on the Philippine Government's decision not to continue with the ZTE-NBN Project are self-serving, hence, inadmissible, the Court has no alternative but to take judicial notice of this official act of the President of the Philippines.

Section 1, Rule 129 of the Rules of Court provides:

SECTION 1. Judicial Notice, when mandatory. – A court shall take judicial notice, without introduction of evidence, of the existence and

³⁷ September 20, 2007 Senate Hearing Testimonies of DOTC Secretary Leandro Mendoza, DOTC Assistant Secretary Lorenzo Formoso III, Department of Justice Chief State Counsel Paras, Transcript available at http://images.gmanews.tv/pdf/nbnzte/senate%20transcripts/ZTE_Senate_Transcript-09202007.pdf.

³⁸ *Suplico v. Nat'l Econ. Dev't Authority*, G.R. No. 178830, Jul. 14, 2008, available at <http://sc.judiciary.gov.ph/jurisprudence/2008/july2008/178830.htm>.

territorial extent of states, their political history, forms of government and symbols of nationality, the law of nations, the admiralty and maritime courts of the world and their seals, the political constitution and history of the Philippines, the official acts of the legislative, executive and judicial departments of the Philippines, the laws of nature, the measure of time, and the geographical divisions. (Emphasis supplied)

Under the rules, it is mandatory and the Court has no alternative but to take judicial notice of the official acts of the President of the Philippines, who heads the executive branch of our government. It is further provided in the above-quoted rule that the court shall take judicial notice of the foregoing facts without introduction of evidence. Since we consider the act of cancellation by President Macapagal-Arroyo of the proposed ZTE-NBN Project during the meeting of October 2, 2007 with the Chinese President in China as an official act of the executive department, the Court must take judicial notice of such official act without need of evidence.

In his dissenting opinion, Justice Antonio Carpio voted to rule on the merits on the ground that any contract entered into without complying with the mandatory provisions of law should be declared null and void. Apparently, he was of the opinion that Section 4 only covers existing treaties at the time R.A. 9184 took effect and not those entered into after the effectivity of the law. Justice Carpio elucidated the point in this manner:

The Government Procurement Reform Act requires public bidding in all procurement of infrastructure, goods and services. Section 10, Article IV of the Government Procurement Reform Act provides:

Section 10. Competitive Bidding – All procurement shall be done through Competitive Bidding, except as provided for in Article XVI of this Act. (Emphasis supplied)

In addition, Section 4 of the Government Procurement Reform Act provides that the Act applies to government procurement “regardless of source of funds, whether local or foreign.” Hence, the requirement of public bidding applies to foreign-funded contracts like the ZTE Supply Contract.

Respondents admit that there was no public bidding for the ZTE Supply Contract. Respondents do not claim that the ZTE Supply Contract falls under any of the exceptions to public bidding in Article XVI of the Government Procurement Reform Act. Instead, private respondent ZTE Corporation claims that the ZTE Supply Contract, being part of an executive agreement, is exempt from public bidding under the last sentence of Section 4 of the Government Procurement Reform Act. Thus, private respondent ZTE Corporation argues:

x x x

Section 4 of R.A. 9184 itself expressly provides that executive agreements that deal on subject matters covered by said law shall be observed. Hence, the requirement of competitive bidding under section 10 of the law is not applicable. Section 4 of R.A. 9184 provides:

Section 4. Scope and Application. - This Act shall apply to the procurement of Infrastructure Projects, Goods and Consulting Services, regardless of source of funds, whether local or foreign, by all branches and instrumentalities of government, its departments, offices and agencies, including government-owned and/or -controlled corporations and local government units, subject to the provisions of Commonwealth Act No. 138. Any treaty or international or executive agreement affecting the subject matter of this Act to which the Philippine government is a signatory shall be observed.

x x x

There is no provision in the Executive Agreement that requires the conduct of competitive public bidding before the award of the NBN Project, or any project envisioned in the RP-China MNOU for that matter. The subsequent exchange of notes between China and the Philippines clearly shows that ZTE was chosen as the contractor for the NBN Project. This was formalized through the DTI-ZTE MOU and the ZTE Supply Contract. (Boldfacing and underlining in the original)

Private respondent ZTE Corporation's argument will hold water if an executive agreement can amend the mandatory statutory requirement of public bidding in the Government Procurement Reform Act. In short, the issue turns on the novel question of whether an executive agreement can amend or repeal a prior law. The obvious answer is that an executive agreement cannot amend or repeal a prior law.

Admittedly, an executive agreement has the force and effect of law, just like implementing rules of executive agencies. However, just like implementing rules of executive agencies, executive agreements cannot amend or repeal prior laws but must comply with the laws they implement. Only a treaty, upon ratification by the Senate, acquires the status of a municipal law. Thus, a treaty may amend or repeal a prior law and vice-versa. Hence, a treaty may change state policy embodied in a prior law.

In sharp contrast, an executive agreement, being an exclusive act of the Executive branch, does not have the status of a municipal law. Acting alone, the Executive has no law-making power. While the

Executive does possess rule-making power, such power must be exercised consistent with the law it seeks to implement.

Consequently, an executive agreement cannot amend or repeal a prior law. An executive agreement must comply with state policy embodied in existing municipal law. This Court has declared:

International agreements involving political issues or changes of national policy and those involving international arrangements of a permanent character usually take the form of treaties. But international agreements embodying adjustments of detail carrying out well-established national policies and traditions and those involving arrangements of a more or less temporary nature usually take the form of executive agreements. (Emphasis supplied)

Executive agreements are intended to carry out well-established national policies, and these are found in statutes.

In the United States, from where we adopted the concept of executive agreements, the prevailing view is that executive agreements cannot alter existing law but must conform with all statutory requirements. The U.S. State Department has explained the distinction between treaties and executive agreements in this manner:

x x x it may be desirable to point out here the well-recognized distinction between an executive agreement and a treaty. In brief, it is that the former cannot alter the existing law and must conform to all statutory enactments, whereas a treaty, if ratified by and with the advice and consent of two-thirds of the Senate, as required by the Constitution, itself becomes the supreme law of the land and takes precedence over any prior statutory enactments. (Emphasis supplied)

As Professor Erwin Chemerinsky states, "So long as the (U.S.) president is not violating another constitutional provision or a federal statute, there seems little basis for challenging the constitutionality of an executive agreement." In the United States, while an executive agreement cannot alter a federal law, an executive agreement prevails over state law.

Likewise, Professor Laurence H. Tribe states that an executive agreement cannot override a prior act of Congress even as it prevails over state law. Thus:

x x x Although it seems clear that an unratified executive agreement, unlike a treaty, cannot override a prior act of Congress, executive agreements, even without Senate ratification, have the same weight as formal treaties in their effect upon conflicting state laws.

Professor Tribe cited *United States v. Gary W. Capps, Inc.*, where the Court of Appeals (4th Circuit) ruled that an unratified executive agreement could not prevail over a conflicting federal law. The U.S. Supreme Court affirmed the appellate court's decision but on non-constitutional grounds.

Clearly, an executive agreement must comply with well-established state policies, and these state policies are laid down in statutes. The Government Procurement Reform Act has laid down a categorical state policy – “All procurement shall be done through Competitive Bidding,” subject only to narrowly defined exceptions that respondents do not invoke here. Consequently, the executive agreement between China and the Philippines cannot exempt the ZTE Supply Contract from the state policy of public bidding.

Private respondent ZTE Corporation further claims that the ZTE Supply Contract is part of the executive agreement between China and the Philippines. This is plain error. An executive agreement is an agreement between governments. The Executive branch has defined an “international agreement,” which includes an executive agreement, to refer to a contract or an understanding “entered into between the Philippines and another government.”

That the Chinese Government handpicked the ZTE Corporation to supply the goods and services to the Philippine Government does not make the ZTE Supply Contract an executive agreement. ZTE Corporation is not a government or even a government agency performing governmental or developmental functions like the Export-Import Bank of China or the Japan Bank for International Cooperation, or a multilateral lending agency organized by governments like the World Bank. ZTE Corporation is a business enterprise performing purely commercial functions. ZTE Corporation is publicly listed in the Hong Kong and Shenzhen stock exchanges, with individual and juridical stockholders that receive dividends from the corporation.

Moreover, an executive agreement is governed by international law. However, the ZTE Supply Contract expressly provides that it shall be governed by Philippine law. Thus, the ZTE Supply Contract is not an executive agreement but simply a commercial contract, which must comply with public bidding as mandated by the governing law, which is Philippine law.

Finally, respondents seek refuge in the second sentence of Section 4 of the Government Procurement Reform Act:

Section 4. Scope and Application - This Act shall apply to the Procurement of Infrastructure Projects, Goods and Consulting Services, regardless of the source of funds, whether local or foreign,

by all branches of the government, its departments, offices and agencies, including government-owned and/or-controlled corporations and local government units, subject to the provisions of Commonwealth Act No. 138. Any treaty or international or executive agreement affecting the subject matter of this Act to which the Philippine government is a signatory shall be observed. (Emphasis supplied)

Respondents argue that the second sentence of Section 4 allows an executive agreement to override the mandatory public bidding in Section 10 of the Government Procurement Reform Act.

Respondents' argument is flawed. First, an executive agreement, being an exclusive act of the Executive branch, cannot amend or repeal a mandatory provision of law requiring public bidding in government procurement contracts. To construe otherwise the second sentence of Section 4 would constitute an undue delegation of legislative powers to the President, making such sentence unconstitutional. There are no standards prescribed in the Government Procurement Reform Act that would guide the President in exercising such alleged delegated legislative power. Thus, the second sentence of Section 4 cannot be construed to delegate to the President the legislative power to amend or repeal mandatory requirements in the Government Procurement Reform Act.

Second, under Section 10 of the Government Procurement Reform Act, the only exceptions to mandatory public bidding are those specified in Article XVI of the Act. These specified exceptions do not include purchases from foreign suppliers handpicked by foreign governments, or from suppliers owned or controlled by foreign governments. Moreover, Section 4 of the Government Procurement Reform Act mandates that the "Act shall apply to the Procurement of Infrastructure Projects, Goods and Consulting Services, regardless of source of funds, whether local or foreign x x x."

Third, the second sentence of Section 4 should be read in conjunction with Section 4 of the Foreign Borrowings Act, which provides:

Section 4. In the contracting of any loan, credit or indebtedness under this Act, the President of the Philippines may, when necessary, agree to waive or modify the application of any law granting preferences or imposing restrictions on international competitive bidding, including among others, Act Numbered Four Thousand Two Hundred Thirty-Nine, Commonwealth Act Numbered One Hundred Thirty-Eight, the provisions of Commonwealth Act Numbered Five Hundred Forty-One, insofar as such provisions do

not pertain to constructions primarily for national defense or security purposes, Republic Act Numbered Five Thousand One Hundred Eighty-Three: Provided, however, That as far as practicable, utilization of the services of qualified domestic firms in the prosecution of projects financed under this Act shall be encouraged: Provided, further, That in case where international competitive bidding shall be conducted preference of at least fifteen per centum shall be granted in favor of articles, materials, or supplies of the growth, production or manufacture of the Philippines: Provided, finally, That the method and procedure in the comparison of bids shall be the subject of agreement between the Philippine Government and the lending institution. (Emphasis supplied)

Likewise, Section 4 of the Government Procurement Reform Act should be read in conjunction with *Section 11-A of the Official Development Assistance Act of 1996*:

Section 11-A. In the contracting of any loan, credit or indebtedness under this Act or any law, the President of the Philippines may, when necessary, agree to waive or modify the application of any provision of law granting preferences in connection with, or imposing restrictions on, the procurement of goods or services: Provided, however, That as far as practicable, utilization of the services of qualified Filipino citizens or corporations or associations owned by such citizens in the prosecution of projects financed under this Act shall be prepared on the basis of the standards set for a particular project: Provided, further, That the matter of preference in favor of articles, materials, or supplies of the growth, production or manufacture of the Philippines, including the method or procedure in the comparison of bids for purposes therefor, shall be the subject of agreement between the Philippine Government and the lending institution. (Emphasis supplied)

Consequently, as construed together, the executive agreements mentioned in the second sentence of Section 4 of the Government Procurement Reform Act should refer to executive agreements on (1) the waiver or modification of preferences to local goods or domestic suppliers; (2) the waiver or modification of restrictions on international competitive bidding; and (3) the method or procedure in the comparison of bids.

The executive agreements cannot refer to the waiver of public bidding for two reasons. First, the law only allows the President to “waive or modify, the application of any law x x x imposing restrictions on international competitive bidding.” The law does not authorize the President to waive entirely public bidding but only the restrictions on public bidding. Thus, the President may restrict the public bidding to suppliers domiciled in the country of the creditor. This is the usual modification on restrictions imposed by creditor

countries. Second, when the law speaks of executive agreements on the method or procedure in the comparison of bids, the obvious assumption is there will be competitive bidding. Third, there is no provision of law allowing waiver of public bidding outside of the well-defined exceptions in Article XVI of the Government Procurement Reform Act.

Respondents, while not raising this argument, cannot also rely on Section 1 of the Foreign Borrowings Act, which provides:

Section 1. The President of the Philippines is hereby authorized, in behalf of the Republic of the Philippines, to contract such loans, credits, including supplier's credit, deferred payment arrangements, or indebtedness as may be necessary and upon terms and conditions as may be agreed upon, not inconsistent with this Act, with Governments of foreign countries with whom the Philippines has diplomatic or trade relations or which are members of the United Nations, their agencies, instrumentalities or financial institutions or with reputable international organizations or non-governmental national or international lending institutions or firms extending supplier's credit deferred payment arrangements x x x . (Emphasis supplied)

A solitary Department of Justice opinion has ventured that the phrase "as may be necessary and upon terms and conditions as may be agreed upon" serves as statutory basis for the President to exempt foreign-funded government procurement contracts from public bidding. This is a mistake. This phrase means that the President has discretion to decide the terms and conditions of the loan, such as the rate of interest, the maturity period, amortization amounts, and similar matters. This phrase does not delegate to the President the legislative power to amend or repeal mandatory provisions of law like compulsory public bidding of government procurement contracts. Otherwise, this phrase would constitute undue delegation of legislative power since there are no standards that would guide the President in exercising this alleged delegated legislative power.

What governs the waiver or modification of restrictions on public bidding is Section 4-A of the Foreign Borrowings Act, which authorizes the President to, "when necessary, agree to modify the application of any law x x x imposing restrictions on international competitive bidding." Section 4 is the specific provision of the Foreign Borrowings Act that deals with the President's authority to waive or modify restrictions on public bidding. Section 1 of the Act does not deal with the requirement of public bidding. Besides, if Section 1 is construed as granting the President full authority to waive or limit public bidding, Section 4 becomes a superfluous provision.

In any event, whatever doubt may have existed before has been erased by the enactment in 2003 of the Government Procurement Reform Act, which reformed the laws regulating government procurement. The following provisions of the Act clearly prescribe the rule that government procurement contracts shall be subject to mandatory public bidding:

Section 3. Governing Principles on Government Procurement. - All procurement of the national government, its departments, bureaus, offices and agencies, including state universities and colleges, government-owned and/or -controlled corporations, government financial institutions and local government units shall, in all cases, be governed by these principles:

- (a) Transparency in the procurement process x x x.
- (b) Competitiveness by extending equal opportunity to enable private contracting parties who are eligible and qualified to participate in public bidding.

x x x.

Section 4. Scope and Application. - This Act shall apply to the Procurement of Infrastructure Projects, Goods and Consulting Services, regardless of source of funds, whether local or foreign, by all branches and instrumentalities of government, its departments, offices and agencies, including government-owned and/or controlled corporations and local government units, x x x.

Section 10. Competitive Bidding. - All procurement shall be done through Competitive Bidding, except as provided for in Article XVI of this Act. (Emphasis supplied)

The only exceptions to mandatory public bidding are procurements falling under any of the narrowly defined situations in Article XVI of the Act, which respondents do not invoke.

Foreign-funded projects of the government are not exempt from public bidding despite executive agreements entered into by the Philippines with creditor countries or lending institutions. In *Abaya v. Ebdane, Jr.*, the Court cited Memorandum Circular No. 104 dated 21 August 1989 issued by the President:

x x x it is hereby clarified that foreign-assisted infrastructure projects may be exempted from the application of the pertinent provisions of the Implementing Rules and Regulations (IRR) of Presidential Decree (P.D.) No. 1594 relative to the method and procedure in the comparison of bids, which may be the subject of agreement between the infrastructure agency concerned and the lending institution. It should be made clear however that public bidding is still required and

can only be waived pursuant to existing laws. (Italicization in the original of the Memorandum Circular; boldfacing supplied)

Executive agreements with lending institutions have never been understood to allow exemptions from public bidding. What the executive agreements can modify are the methods or procedures in the comparison of bids, such as the adoption of the competitive bidding procedures or guidelines of the Japan Bank for International Cooperation or the World Bank on the method or procedure in the evaluation or comparison of bids. It is self-evident that these procedures or guidelines require public bidding.

Even so-called tied loans from creditor countries cannot justify exemption from public bidding although the bidders may be limited to suppliers domiciled in the creditor countries. Such a geographic restriction on the domicile of suppliers can be the subject of an executive agreement as a modification of restrictions on international competitive bidding. A publication issued by public respondent National Economic and Development Authority summarizes the international practice on tied loans with respect to public bidding:

The conditions imposed by the donor on the recipient with respect to ODA utilization provide another basis for differentiating ODA. In particular, restriction of the geographic areas where procurement of goods and services are eligible for ODA funding make ODA loan/grant tied or untied with respect to source of procurement. Usually, bilateral ODA is tied to the donor country in terms of procurement. While competitive bidding is still practiced, qualified bidders for the supply of goods and services are confined to those firms which are owned or controlled by nationals of the donor country. x x x (Emphasis supplied)

Even for tied loans, the international practice still requires public bidding although the public bidding is restricted only among suppliers that are nationals of the creditor country. In the present case, there was no such public bidding because the Export-Import Bank of China simply handpicked ZTE Corporation as the supplier of the goods and services to the Philippine Government.

That the funding for the ZTE Supply Contract will come from a foreign loan does not negate the rationale for public bidding. Filipino taxpayers will still pay for the loan with interest. The need to safeguard public interest against anomalies exists in all government procurement contracts, regardless of the source of funding. Public bidding is the most effective means to prevent anomalies in the award of government contracts. Public bidding promotes transparency and honesty in the expenditure of public funds. Public bidding is accepted as the best means of securing the most advantageous price for the government, whether in procuring

infrastructure, goods or services, or in disposing off government assets.

Even in a Build-Operate-Transfer project where the proponent provides all the capital with no government guarantee on project loans, the law requires public bidding in the form of a Swiss challenge. With more reason should a project financed by a tied loan to the government be subject to public bidding. There is no sound reason why the Philippine government should allow its foreign creditor in an already tied loan to handpick the supplier of goods and services.

A tied loan, driven by a handpicked supplier, violates the principle of fair and open process in government procurement transactions. Such a tied loan, which arbitrarily reserves a contract to a pre-determined supplier, will likely lead to anomalies. This is contrary to the state policies enunciated in Sections 27 and 28, Article II of the Constitution:

Section 27. The State shall maintain honesty and integrity in the public service and take positive and effective measures against graft and corruption.

Section 28. Subject to reasonable conditions prescribed by law, the State adopts and implements a policy of full public disclosure of all its transactions involving public interest.”³⁹

There is still a pending case where the Court could finally clarify this matter.⁴⁰ A challenge against the legality of the Northrail contract is currently pending before the Regional Trial Court of Makati. Immediately upon its filing, CNMEG, the designated Chinese contractor, filed a motion to dismiss⁴¹ on the ground that the contract is an executive agreement and as such, immune from suits before Philippine courts. The Regional Trial Court ruled that the contracts comprising the Northrail project were not treaties on two grounds – 1) they are governed by domestic laws; and 2) the States did not treat them as treaties. The Regional Trial Court states:

It is significant to note that in all these Agreements, the principal parties are Northrail and CNMEG without any specific reference or mention of the Peoples Republic of China and the Republic of the

³⁹ See note 38, Dissenting Opinion of Justice Antonio Carpio, available at <http://sc.judiciary.gov.ph/jurisprudence/2008/july2008/178830-carpio.htm>.

⁴⁰ See *China National Machinery and Equipment Corp. v. Hon. Cesar Santamaria Presiding Judge Regional Trial Court Branch 145 Makati City et.al.*, CA-G.R. SP NO. 103551, Sep. 30, 2008.

⁴¹ See *Roque Jr., v. Office of the Exec. Sec.*, Civil Case No. 06-203 docketed at Regional Trial Court Branch 145 Makati City. Omnibus Order dated May 15, 2007.

Philippines as parties in the said Agreement. On this point, it is more preponderant that these Agreements cannot be validly and effectively classified as an Executive Agreement to place it beyond the ambit of suability. As they are not directly concluded between the two Sovereign States. Additionally, the claim that CNMEG is an agent of the Peoples Republic of China cannot likewise be given due course in the absence of Certification from the Department of Foreign Affairs of the Government to the effect that the said defendant is entitled to immunity being a bonafide agent of the Sovereign State in accordance with the cited case of *Holy See vs. Rosario Jr.*, 282 SCRA 524, 531,532.

Anent the claim of immunity from suit, the court ruled that since the building of a railway is proprietary in nature, CNMEG cannot be in the discharge of a sovereign function and is therefore not immune from local jurisdiction:

As earlier stated, it is not the public purpose which is determinative of the particular act of the sovereign but the nature and character of its activity. Again, an examination of these Memoranda of Understanding referred to above will readily disclose that the Transactions between Northrail and CNMEG are business and commercial activities between the two of them as explicitly shown by the terms and conditions of Agreements, particularly the Memorandum of Understanding of 30 August 2003, which states that the Import-Export Bank of China will make available to the Philippines a loan in the amount of P400,000,000.00 payable within the period of twenty (20) years inclusive of the five-year grace period, with the rate of interest of three (3%) percent per annum.

Similarly, the succeeding Agreement between Northrail and CNMEG relative to the Implementation of the Project (Section 1, page 1, Caloocan-Malolos) provides for the imposition of financing charges compounded monthly, on the amount unpaid during the period of delay, upon Northrail at the rate of five (5%) percent annually. These are all irrefragable indicia of business or commercial transaction between the two corporate entities.

Corollarily, contrary to the contention of the defendant CNMEG is not in pursuit of a sovereign activity or an incident thereof, thus, an act jure gestionis. This illation is buttressed by the fact that the transaction in question was definitely concluded by CNMEG for gain or profit as shown by their explicit terms and conditions particularly as regards to the payment of the loan with interest and financing charges compounded at that.

CNMEG has since filed a Petition for Certiorari with the Court of Appeals on the same issues.⁴² Using similar reasoning, the Court of Appeals also dismissed the case, adding that the matter of immunity from local jurisdiction should have been certified to by the Department of Foreign Affairs. The Court of Appeals stated:

The manner of securing such executive endorsement varies in this country. But the bottomline is, it must come from the DFA which is the proper government agency with administrative competence to perform the task associated with diplomacy and foreign relations.

In *Holy See vs. Rosario*, the DFA discussed the varied ways on how said endorsement was done citing several cases, thus: In *International Catholic Migration Commission v. Calleja*, the Secretary of Foreign Affairs just sent a letter directly to the Secretary of Labor and Employment, informing the latter that the respondent-employer could not be sued because it enjoyed diplomatic immunity. In *World Health Organization v. Aquino*, the Secretary of Foreign Affairs sent the trial court a telegram to that effect. In *Baer v. Tizon*, the U.S. Embassy asked the Secretary of Foreign Affairs to request the Solicitor General to make, in behalf of the Commander of the United States Naval Base at Olongapo City, Zambales, a "suggestion" to respondent Judge. The Solicitor General embodied the "suggestion" in a Manifestation and Memorandum as *amicus curiae*.

Executive Order No. 292, otherwise known as the Administrative Code of 1987 and Executive Order No. 459 provide that all treaties and executive agreements shall be negotiated by the DFA.

The authority and competence of the DFA regarding this matter was even recognized by Commercial Counselor Yu Shizhong of the Economic and Commercial Office of the Embassy of the People's Republic of China in his certification when it stated that "Any and all matters which the Philippino (sic) would like to raise to the mandated Prime Contractor must be brought to the attention of our Government through the Department of Foreign Affairs of the Republic of the Philippines so that proper discussions can be made between the two governments at the appropriate diplomatic levels.

In *Holy See*, the Supreme Court went further to state that in cases where foreign states bypass the Foreign Office, the courts can inquire into the facts and make their own determination as to the nature of the acts and transactions involved. Petitioner CNMEC's assertion that its status as an agent of PROC was already recognized by the other department/branches of the executive which is of co-equal

⁴² See note 40.

rank of the DFA is of no moment since other offices do not have the competence to do the work involving diplomatic and foreign relations. This matter should be coursed through the DFA and not with any other branches of the executive department.”

The subsequent motion for reconsideration filed by CNMEG was also dismissed for having utter lack of merit. CNMEG has since filed a Motion for an Extension of Time to File Petition for review with the Supreme Court.

With the Northrail controversy now pending in the Supreme Court, it is hoped that it will result in the Court making a definitive ruling on the construction of Section 4 of R.A. 9184, particularly on the issue of whether or not it applies to all treaties, executive agreements or international agreements entered into by the Philippine Government relative to its procurement requirements, or whether it should be limited to those already existing at the time R.A. 9184 took effect. This is of paramount importance given the Executive’s propensity to insist on its prospective application, constituting yet another ground for deviating from the mandatory provision of law requiring public bidding in all government procurement.

This clarification is especially necessary because the DBM ruling, citing the Abaya case, unequivocally stated that “loan agreements are executive agreements” and hence beyond the coverage of RA 9184. Unless clarifications are made on these issues, controversies such as those attendant to the NBN-ZTE and the Northrail contracts will hound the Philippines and will continue to be a source of political discord in the country.

In any event, the Court in resolving the Northrail controversy is bound to uphold existing policies provided in R.A. 9184 itself. These policies include:

Section 3. Governing Principles on Government Procurement.

- (a) Transparency in the procurement process and in the implementation of procurement contracts.
- (b) Competitiveness by extending equal opportunity to enable private contracting parties who are eligible and qualified to participate in public bidding.
- (c) Streamlined procurement process that will uniformly apply to all government procurement. The procurement process shall simple and made adaptable to advances in modern technology in order to ensure an effective and efficient method.

(d) System of accountability where both the public officials directly or indirectly involved in the procurement process as well as in the implementation of procurement contracts and the private parties that deal with government are, when warranted by circumstances, investigated and held liable for their actions relative thereto.

(e) Public monitoring of the procurement process and the implementation of awarded contracts with the end in view of guaranteeing that these contracts are awarded pursuant to the provisions of this Act and its implementing rules and regulations, and that all these contracts are performed strictly according to specifications.

Stated differently, if the Court were to uphold the Executive's construction of R.A. 9184, how would doing away with open and competitive biddings promote established legislative policies of transparency, competitiveness and accountability in government procurement?

Meanwhile, with China in possession of no less than 20 trillion yuan in Gross Domestic Product as of 2007⁴³ and as much as \$1.2 trillion foreign reserves-backed foreign assets in 2007⁴⁴, the question remains: if China will insist on its current policy of designating project contractors to its tied loans, should we continue to avail of these Chinese "tied" loans amidst these legal uncertainties? Are there alternatives? And in the event there are none, which should we prevail: Chinese conditionalities or Philippine laws? Answers should be found soon for China continues to utilize its surplus capital in pursuit of its "soft power".⁴⁵

CONCLUSION

Developing countries like the Philippines face an acute dilemma: while it is undeniable that capital is needed to finance infrastructure- and capital-intensive projects, there is an equally important need to create mechanisms that will ensure transparency and accountability in government

⁴³ People's Daily Online, *China's GDP tops 20 trillion yuan last year*, available at http://english.peopledaily.com.cn/200701/14/eng20070114_341079.html.

⁴⁴ Clay Chandler, *China's \$1.2 trillion cash hoard*, FORTUNE MAGAZINE, May 3, 2007 available at http://money.cnn.com/magazines/fortune/fortune_archive/2007/05/14/100024842/index.htm.

⁴⁵ JOSHUA KURLANTZICK, CHARM OFFENSIVE: HOW CHINA'S SOFT POWER IS TRANSFORMING THE WORLD 6 (2007). Kurlantzick defines soft power from the Chinese perspective as "soft power means anything outside of the military and security realm, including not only popular culture and public diplomacy but also more coercive economic and diplomatic levers like aid and investment and participation in multilateral organizations-Nye's carrots and sticks."

procurement contracts. This dilemma is compounded by the fact that with today's economic downturn, even developed countries like the United States are looking to China as a source of financing and investment. Given China's insistence in designating contractors as a loan condition, should developing countries "bite the bullet"?

The Philippine experience is instructive. For while the Philippine President sought to justify these Chinese-funded projects on the basis of economics and feasibility, the Filipino people spoke out against it. Ultimately, the President had no recourse but to heed the popular sentiment and cancel at least one of these projects. This was political brilliance. Otherwise, entering into a grossly disadvantageous Chinese "tied loan" could have given the public yet another reason to resort to "people power", a peaceful uprising that has in the past been used by the Filipino people as a statement against the government.

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