

# A Study on the Effectiveness of the Philippines' Procurement Security and Guarantee Instruments

June 2004

Submitted to:

**THE WORLD BANK**

Submitted by:

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**ABBREVIATIONS AND ACRONYMS**

|          |  |
|----------|--|
| ADB      | Asian Development Bank   |
| BAC      | Bids and Awards Committee  |
| BOC      | Bureau of Customs  |
| BSP      | Bangko Sentral ng Pilipinas  |
| CIAP     | Construction Industry Authority of the Philippines   |
| COBAC    | Central Office Bids and Awards Committee   |
| CPAR     | Country Procurement Assessment Report  |
| DBM      | Department of Budget and Management  |
| DepEd    | Department of Education  |
| DOH      | Department of Health   |
| DOSRI    | Total outstanding unsecured credit accommodations, both direct and indirect, to directors, officers, stockholders, and their related interests   |
| DOTC     | Department of Transportation and Communications  |
| DND      | Department of National Defense   |
| DPWH     | Department of Public Works and Highways  |
| E.O.     | Executive Order  |
| E.O. 262 | Executive Order No. 262, series of 2000, entitled "Amending Executive Order No. 302, Series of 1996, Entitled 'Providing Policies, Guidelines, Rules and Regulations for the Procurement of Goods/Supplies by the National government' and Section Three (3) of Executive Order No. 201, Series of 2000, Entitled 'Providing Additional Policies and Guidelines in the Procurement of Goods and Supplies by the National Government.'" |
| E.O. 40  | Executive Order No. 40, series of 2001, entitled "Consolidating Procurement Rules and Procedures for all National Government Agencies, Government-Owned or – Controlled Corporations and Government Financial Institutions, and Requiring the Use of the Government Electronic Procurement System," and signed by President Arroyo on October 8, 2001  |
| GAA      | General Appropriations Act   |
| GOP      | Government of the Philippines  |
| GPPB     | Government Procurement Policy Board  |
| GPRA     | Government Procurement Reform Act (R.A. 9184)  |
| GSIS     | Government Service Insurance System  |
| IFI      | International Financing Institution  |
| IRR      | Implementing Rules and Regulations   |

|           |   |
|-----------|---|
| IRR-A     | The Implementing Rules and Regulations Part A of R.A. 9184  |
| JBIC      | Japan Bank for International Cooperation  |
| JCOG      | Joint Congressional Oversight Committee   |
| LBP       | Land Bank of the Philippines  |
| LC        | Letter of Credit  |
| LGU       | Local Government Unit   |
| NCA       | Notice of Cash Allocation   |
| NEDA      | National Economic and Development Authority   |
| NGO       | Non-governmental Organization   |
| PBAC      | Pre-qualification Bids and Awards Committee   |
| P.D.      | Presidential Decree   |
| P.D. 1177 | Presidential Decree No. 1177, dated July 30, 1977, as amended by P.D. 1777, otherwise known as the Budget Reform Decree of 1977”                              |
| P.D. 1594 | Presidential Decree No. 1594, dated June 11, 1978, entitled “ Prescribing Policies, Guidelines, Rules and Regulations for Government Infrastructure Projects” |
| PIRA      | Philippine Insurance Rating Association   |
| PWI       | Procurement Watch Inc.  |
| R.A.      | Republic Act  |
| R.A. 386  | Republic Act No. 386, as amended, otherwise known as the “Civil Code of the Philippines”  |
| R.A. 8791 | Republic Act No. 8791, otherwise known as the “General Banking Law of 2000”   |
| R.A. 9184 | Republic Act No. 9184, otherwise known as the “Government Procurement Reform Act”   |
| SBL       | Single Borrower’s Limit   |
| SEMP      | Social Expenditure Management Project   |
| SONA      | State of the Nation Address   |
| TWG       | Technical Working Group   |
| WB        | World Bank  |
| WBOM      | World Bank Office Manila  |

## **EXECUTIVE SUMMARY**

As a product of the GOP's comprehensive public procurement reform program, R.A. 9184 is a major reform measure prioritized by the GOP to check leakages in public funds brought about by graft and corruption, inefficiency and the lack of professionalism in Government procurement. To complement this program, from October 2001 to June 2002, the WBOM and the GOP, with the participation of the Asian Development Bank, conducted the Country Procurement Assessment Report (CPAR) in order to provide a venue for various agencies to share experiences on procurement practices and develop an action plan to improve the entire system. In this regard, it should be noted that the GOP was strongly involved in preparing the CPAR and has, therefore, an equally strong claim of ownership over the same.

One of the major recommendations of the CPAR was to discourage all forms of securities that cannot be garnished immediately, as well as to study and develop alternative means to make the system flexible but ensure that the objectives in imposing bid and performance securities are attained. For this reason, the World Bank has engaged the proponent to develop a Study to confirm whether or not, in the actual experiences of agencies, surety bonds are indeed difficult to garnish, and whether bank guarantees and irrevocable LCs are not easily accessible to bidders. This Study is further intended to review the effectiveness of the current bid and performance security and guarantee instruments in the Philippines and to recommend alternative ways to protecting the integrity of the procurement process while reducing the risk to government agencies of contract non-performance by the contractor and supplier.

To properly review and evaluate the effectiveness of security instruments in the Philippines, the Study primarily adopts the judgment model of evaluation, which is one based upon professional judgment and the very experience and expertise that are being evaluated, so that it carries the advantages of easy implementation and the absence of time lag while waiting for data analysis – considerations that find notability in a situation that offers limited time frame and resources – as well as the ability to bring all variables into account. However, the Study is limited to the central offices of the DOH, DepEd and DPWH; and, as such, does not cover the contracts and procurement activities of the decentralized offices of these Departments. These agencies were pre-identified as among the procurement intensive Departments of the GOP. Also, the Study primarily focuses on irrevocable letters of credit, bank guarantees and surety bonds as bid and performance securities in public procurement conducted through public bidding.

Understandably, the evaluation is undertaken against the backdrop of the various laws and jurisprudence that govern bid and performance securities. In this regard, R.A. 9184 provides for three (3) situations that call for securities, namely:

1. in Section 27, on Bid Securities;
2. in Section 39, on Performance Securities; and
3. in Section 62, on Warranties.

However, of the various forms of securities available to bidders, winning bidders, suppliers, contractors and consultants, the Study will primarily focus on irrevocable letters of credit, bank guarantees and surety bonds.

In providing for an “irrevocable” letter of credit, R.A. 9184 and its IRR-A actually refer to a “standby” letter of credit, which pertains to an accommodation from a bank to assume or secure the liabilities/obligations of third parties in case of the latter’s inability to perform an undertaking, such as that of submitting a bid, performing a contract or fulfilling a warranty. A standby letter of credit and a bank guarantee are practically the same, because they both have the same purpose, that is to secure the liabilities or obligations of third parties, and they both entail similar procedures and requirements for application and claims. However, the same cannot be said as between a guarantee and a surety bond. A “guarantor” and a “surety,” though alike in that both are bound for another, differ from each other, because the obligation of the guarantor is secondary, a guarantor undertaking to pay if by due diligence the debt cannot be collected of the principal, while the obligation of a surety is primary, and the surety is bound equally and solidarily with the principal and is a debtor from the beginning.

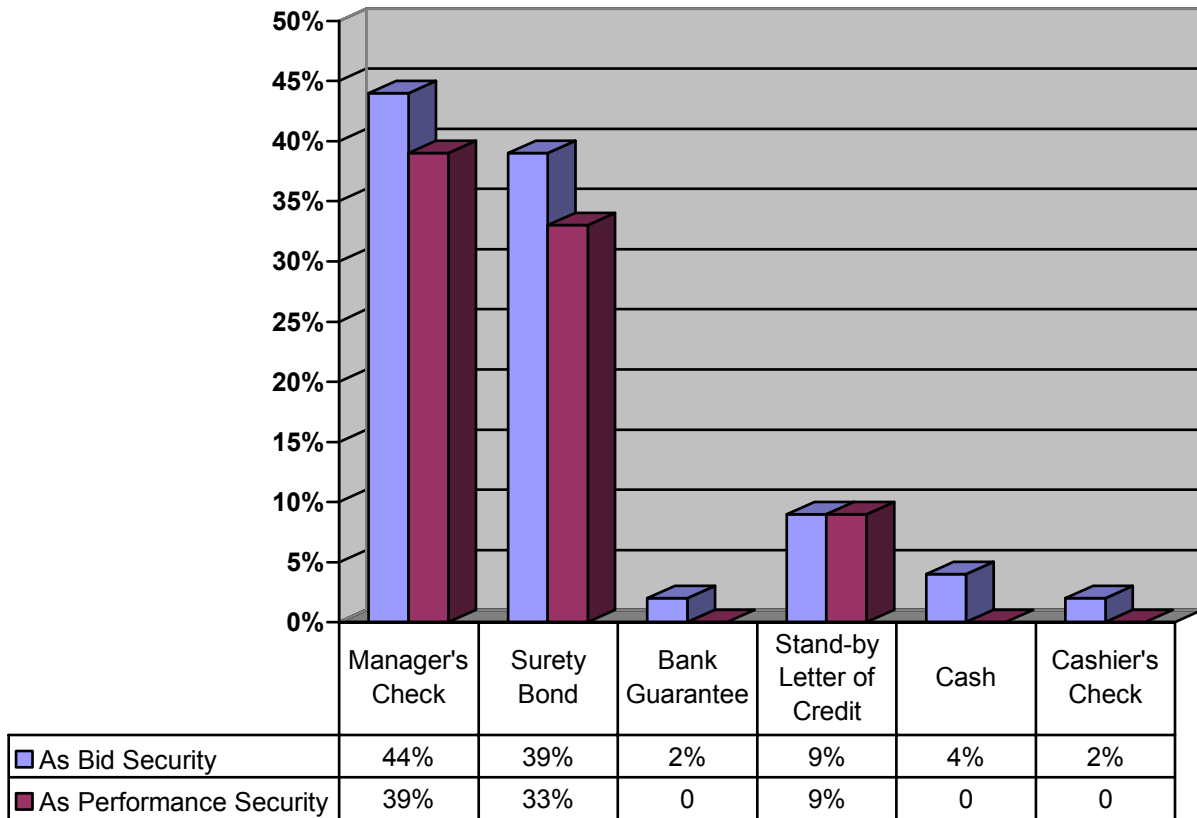
An issue that has been the subject of much discussion among government agencies is whether surety bonds are truly “callable on demand.” The general sentiment is that if a surety bond is “callable on demand,” it implies that it should be immediately payable upon a claim being made therefor, but agencies have alleged having difficulties because court action is usually required before one can successfully claim against a surety or insurance company. Addressing this issue actually involves having to address other interrelated issues pertaining to GSIS surety bonds, in particular, and the legal concept of surety bonds, in general. Therefore, a portion of the Study is dedicated to further analyzing GSIS surety bonds, by reviewing the policies, rules and procedures of the GSIS on the application for surety bonds and the processing of claims, vis-à-vis the general laws on suretyship. Thereafter, a legal analysis will be made to further explicate the true nature of surety bonds. This analysis will show that any difficulty experienced by an agency in claiming against a surety bond is not necessarily the result of the internal practices, policies, rules and procedures of any particular surety or insurance company, nor that of any locally established business custom, but rather one that finds its roots in the very nature of a suretyship contract brought forth by well-entrenched laws and jurisprudence – both local and foreign. Therefore, any effort to address this difficulty, short of striking out surety bonds as bid and performance securities altogether, may actually entail amending established principles in law and jurisprudence.

Moving unto actual and practical experiences of the subject agencies, based upon the interviews conducted, the following were discovered:

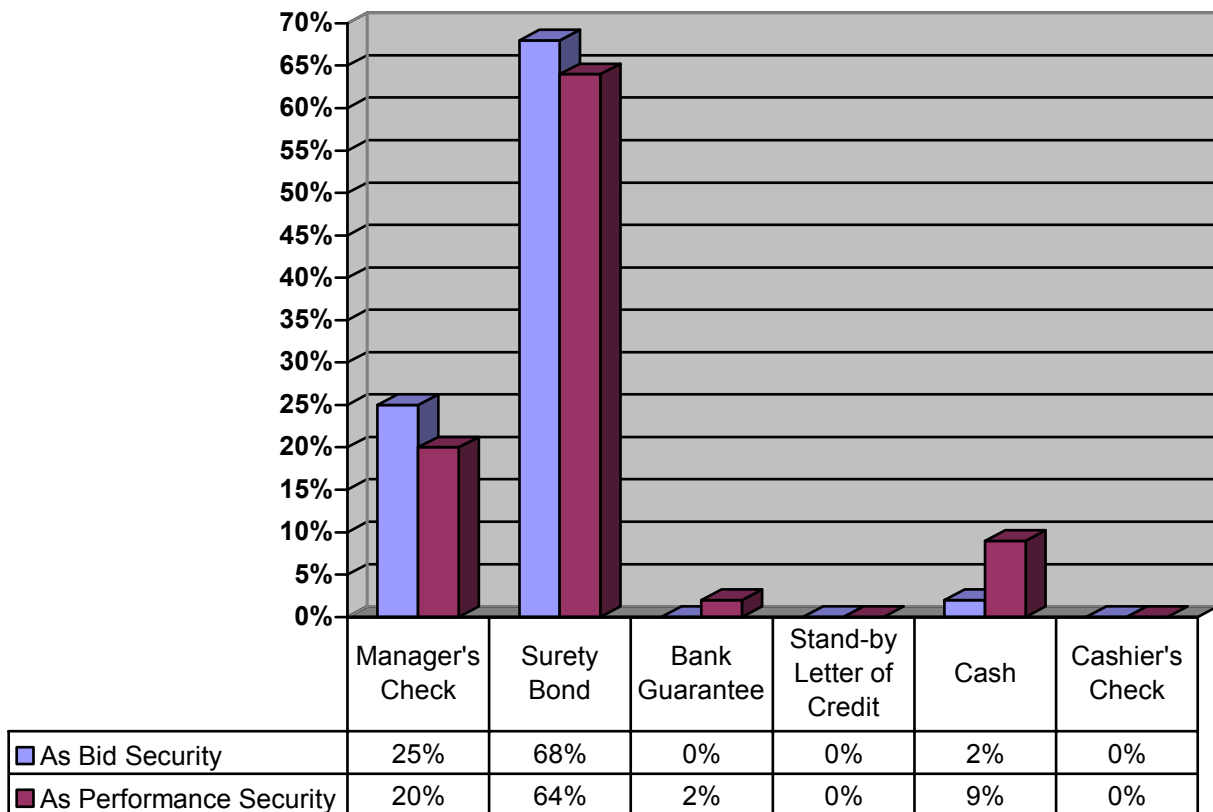
| <b>DOH</b>  | <b>DepEd</b>                                      | <b>DPWH</b>  |
|---|---|--|
| 1. Does not allow the submission of surety bonds. | 1. Does not allow the submission of surety bonds. | 1. Allows contractors to submit surety bonds as bid and performance securities, except for some foreign-assisted projects, because, except for JBIC, |

|  |  |   |
|--|--|---|
|  |  | <p>IFIs generally do not allow the submission of surety bonds. However, the removal of surety bonds is favored, because there are other forms of security that provide greater protection.</p> <p>The requirement of a surety bond is not limited to those issued by the GSIS.</p>                                  |
| <p>2. For locally funded projects, suppliers tend to prefer managers' checks and bank guaranties as bid and performance securities.</p> <p>For foreign-assisted projects, bank guaranties and letters of credit are more common.</p> | <p>2. For both local and foreign-assisted projects, suppliers tend to prefer managers' checks and bank guaranties as bid and performance securities.</p> <p>Additionally, for foreign-assisted projects, a few suppliers submit letters of credit.</p> | <p>2. For locally funded projects, contractors tend to favor surety bonds as bid and performance securities.</p> <p>Except for JBIC, IFIs generally do not allow the submission of surety bonds and only allow bank guaranties and letters of credit, thereby practically eliminating contractors' preferences.</p> |
| <p>3. Allows the submission of cash as bid and performance securities.</p>   | <p>3. Does not allow the submission of cash for both bid or performance securities.</p>  | <p>3. Allows the submission of cash as bid and performance securities.</p>  |
| <p>4. Cash and other securities equivalent to cash are deposited with the National Treasury.</p>   | <p>4. Securities equivalent to cash are, in most instances, held by the BAC Secretariat, subject to the issuance of a receipt.</p>   | <p>4. Cash and other securities equivalent to cash are deposited with the National Treasury.</p>  |
| <p>5. Reported no problems in 2002 and 2003 with respect to the garnishment of securities.</p>   | <p>5. No problems reported, because there were no reported claims filed against securities, nor any call made upon a security, in 2002 and 2003.</p>   | <p>5. Reported no problems in 2002 and 2003 with respect to the garnishment of securities, because it alleged a high success rate of recovery.</p>  |
| <p>6. Does not favor removing bid securities.</p>  | <p>6. Does not favor removing bid securities.</p>  | <p>6. Does not favor removing bid securities.</p>   |

With respect to suppliers doing business with the government, the graph below shows a summary of the results of a survey on preferred bid and performance securities:



On the part of government contractors, the graph below shows a summary of the results of a similar survey on preferred bid and performance securities:



Based upon the foregoing, the Study analyzes the actual effectiveness of standby letters of credit, bank guarantees and surety bonds, and provides specific recommendations on the following matters:

- The retention of bid securities
- Views on alternatives suggested by suppliers and contractors, vis-à-vis existing reforms
- The staggered removal of surety bonds
- Concerns raised over GSIS surety bonds
- The practice of depositing cash and cash equivalent securities
- The proper monitoring of securities and their validity periods
- Lowering the collateral requirement for standby LCs and bank guarantees with waiver of excussion
- Providing a clear definition of the term “reputable”
- A clarification on when performance securities have to be posted
- The concerns raised on the new warranty requirement of R.A. 9184

**I. BACKGROUND OF THE STUDY****A. Terms of Reference**

From October 2001 to June 2002, the WBOM and the GOP, with the participation of the Asian Development Bank, conducted the Country Procurement Assessment Report (CPAR) to assess the public procurement system in the Philippines and, in the process, generate a dialogue with the GOP on needed reforms.<sup>1</sup> The CPAR was finally published in March 2003, providing a comprehensive analysis of the Philippines' public procurement system, including existing legal framework, organizational responsibilities and control, oversight and regulatory framework and capabilities, procurement processes and practices, decentralized procurement in the LGU level, and procurement in externally financed projects.

An interesting feature of the CPAR is that it comes in the heels of a comprehensive GOP public procurement reform program of the Arroyo administration. In particular, on January 10, 2003, President Gloria Macapagal Arroyo signed into law R.A. 9184, entitled "An Act Providing for the Modernization, Standardization and Regulation of the Procurement Activities of the Government and for Other Purposes," otherwise known as the "Government Procurement Reform Act" (GPRA). R.A. 9184 was published on January 11, 2003, in two (2) newspapers of general nationwide circulation, namely Malaya and the Manila Times, and in accordance with Section 78 thereof, took effect fifteen (15) days following the said publications, or on January 26, 2003.

Section 75 of R.A. 9184 provides that, within sixty (60) days from the promulgation thereof, "the necessary rules and regulations for the proper implementation of its provisions shall be formulated by the GPPB, jointly with the members of the Oversight Committee." Accordingly, with the assistance of the same Inter-Agency Technical Working Group that drafted E.O. 40, an earlier issuance dealing with public procurement reform, as well as the various versions of the Procurement Reform Bill, the IRR for R.A. 9184 was formulated by the GPPB and the JCOC. As agreed during a meeting held jointly by the GPPB and the JCOC on July 11, 2003, both bodies, through Joint Resolution No. 01-2003, endorsed the IRR, labeled as IRR-A of R.A. 9184, to the President of the Philippines, for her approval and signature. As further agreed in the same meeting, this IRR-A is meant to govern only fully domestically-funded procurement activities, because another set of IRR (IRR-B) is intended to be issued to address foreign-assisted projects. Through Memorandum Order No. 119, issued on September 18, 2003, the President formally approved IRR-A of R.A. 9184. As such, on September 23, 2003, M.O. 119 and IRR-A were published in two (2) newspapers of general nationwide circulation, namely Malaya and Manila Times, and, in accordance with Section 78 thereof, IRR-A took effect fifteen (15) calendar days after the said publications, or particularly on October 8, 2003.

R.A. 9184 is a major reform measure prioritized by the GOP to check leakages in public funds brought about by graft and corruption, inefficiency and the lack of

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<sup>1</sup> See The World Bank, *Philippines: Country Procurement Assessment Report*, at 9 (March 2003).

professionalism in Government procurement. No less than President Gloria Macapagal-Arroyo herself underscored the importance of public procurement reform in her State of the Nation Addresses (SONA). For example, in her July 2001 SONA, President Arroyo stressed the urgent need for good governance, and when Congress failed to pass the Government Procurement Reform Bill, she showed resolution by streamlining procurement and consolidating various procurement rules and regulations through E.O. 40.<sup>2</sup> In connection to this, in her July 28, 2003 SONA, President Arroyo took the opportunity to thank Congress for passing R.A. 9184.

The CPAR clearly complemented the GOP public procurement reform program by providing a venue for various agencies to share experiences on procurement practices and develop an action plan to improve the entire system. It should be noted that the GOP was strongly involved in preparing the CPAR and has, therefore, an equally strong claim of ownership over the same.

It is also interesting to note that the CPAR provided several comprehensive recommendations to reform the Philippines' public procurement regime, one of which was actually the passage of an omnibus procurement law. Another important recommendation pertains to the bid and performance securities. Specifically, under the heading "Government Procurement Processes and Practices," in Paragraph 2.21 of the CPAR, one of the main concerns expressed was that:

[I]t is common to use surety bonds as bid and performance security. Unfortunately, these surety bonds are not really callable on demand and are very difficult to garnish. The practice demonstrates that a surety bond is not an irrevocable guarantee. Most foreign-assisted projects require bank guarantees or an irrevocable letter of credit as the form of bid and performance securities. However, on the other hand, bank guarantees and irrevocable LCs are not easily accessible to bidders, suppliers and contractors since Banks in the country are asking for the full amount of guaranty to protect themselves. In this instance, it would be practical to study and develop alternative means to make the system flexible but ensure that the objectives in imposing bid and performance securities are attained.<sup>3</sup>

The CPAR further provided the following recommendation:

Discourage all forms of securities that cannot be garnished immediately. On bid security, the Bank could help in designing "on demand" satisfactory securities, which could be issued by non-banking institutions. An alternative is, in lieu of bid security for small value contracts, establishing penalties in the new law and its IRRs, such as suspensions for bidders who do not sign the contract. For performance securities, the Bank could help in designing one which could be issued by non-banking institutions.<sup>4</sup>

In view of the immediately preceding recommendation, the World Bank has engaged the proponent to conduct a Study that will confirm whether or not, in the actual

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<sup>2</sup> *Id.*, at 14.

<sup>3</sup> *Id.*, at 27.

<sup>4</sup> *Id.*, at 28.

experiences of agencies, surety bonds are indeed difficult to garnish, and whether bank guarantees and irrevocable LCs are not easily accessible to bidders. This Study is further intended to determine whether any difficulty encountered in the garnishment of surety bonds are the result of faulty practices, procedures and policies on the part of the issuing entity. This Study also seeks to look into alternative means to make the procurement security/guarantee requirement flexible without sacrificing the overall objective of securing the procurement process and contract implementation; and, in the process, determine the feasibility of the initial CPAR recommendations mentioned above.

The overall objective of this Study is to review the effectiveness of the current bid and performance security and guarantee instruments in the Philippines and to recommend alternative ways to protecting the integrity of the procurement process while reducing the risk to government agencies of contract non-performance by the contractor and supplier.

### ***B. Limitations of the Study***

Although this Study is intended to review the effectiveness of security instruments that are available in the public procurement regime of the Philippines, it is limited to the central offices of the DOH, DepEd and DPWH; and, as such, does not cover the contracts and procurement activities of the decentralized offices of these Departments. These agencies were pre-identified as among the procurement intensive Departments of the GOP. Also, the Study primarily focuses on irrevocable letters of credit, bank guarantees and surety bonds as bid and performance securities in public procurement conducted through public bidding, but also provides an analysis of bid and performance securities in general. Considering that the CPAR pinpoints surety bonds as not being callable on demand and as very difficult to garnish, particular attention and emphasis is given by the proponent on this particular type of security.

In reporting the experiences of each Department, emphasis is placed on the practical experiences of the procurement, contracting and/or legal officers or employees interviewed. Due to time constraints and the unavailability of some documented materials, the reports are primarily based upon first hand accounts of the interviewees. Moreover, considering that the proponent was only given a short time frame to complete the Study, the interviews conducted may not be as meticulous as one may perform under a longer timeframe, but they are deemed sufficient enough to provide the reader with a working idea of the subject matter involved, and are, at the least, in proportion to the time provided. The given time frame, vis-à-vis the intricacy of the subject matter of evaluation, is one of the factors why the proponent has decided to primarily adopt the judgment model of evaluation, as will be explained in the next sub-section. Finally, all findings, conclusions and recommendations in this Study are generally limited to records and events that transpired during the last two (2) years, *i.e.* 2002 and 2003.

### ***C. Research Methods***

To properly review and evaluate the effectiveness of security instruments in the Philippines, the practical experiences and personal views of the key players in a

security instrument have to be gathered. It is for this reason that the Study primarily adopts the judgment model of evaluation, which is one based upon professional judgment and the very experience and expertise that are being evaluated, so that it carries the advantages of easy implementation and the absence of time lag while waiting for data analysis – considerations that find notability in a situation that offers limited time frame and resources – as well as the ability to bring all variables into account.<sup>5</sup> As such, data for the Study were acquired through various means, depending on the respondents concerned and the specific subject matter covered.

However, in order to provide the background and bases needed to support reasoned, practical and realistic recommendations, the Study first establishes the legal environment before proceeding to gather the actual experiences, preferences, sentiments and good practices among all the primary stakeholders, namely the government, the guarantors, and the bidders. This is done through in-depth legal research covering the various laws and jurisprudence governing bid and performance securities, in general, and irrevocable letters of credit, bank guarantees and surety bonds, in particular. This research not only includes domestic laws, but also international jurisprudence, as well as universally accepted legal principles and customs.

Having given the legal framework as a backdrop, the Study then gathers the experiences of the GOP with respect to procurement securities. The GOP was represented by procurement intensive agencies, namely the DOH, DepEd and DPWH, and data were validated through actual records, if available. To further validate the results of the interviews with the GOP agencies, and to determine the practice of those that deal with the issuance of these performance securities, separate interviews and documentation were conducted on the side of the banks, surety and insurance companies – as represented by the GSIS, one private insurance company, the LBP and one (1) private commercial bank.

Finally, to capture a complete and unbiased picture of all issues and views from all those involved in procurement, the Study not only needs to ascertain the stand of the government and the security issuers, but it has to determine the sentiments of those who contract with it as well. As such, the views, experiences, preferences and sentiments of the suppliers and contractors were gathered through a survey that covered the basic issues and concerns of this Study. The survey questionnaires were either distributed through facsimile or answered through telephone inquiries. The respondents were randomly chosen from the suppliers registered with the Government Electronic Procurement System and the contractors registered with the CIAP. As pointed out, the interesting feature of this approach is that the results of the interview of each category of respondents may be matched against each other, especially since not all government officials interviewed were able to provide the proponent with records to support their claims.

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<sup>5</sup> See Kenneth J. Euske, *Management Control: Planning, Control, Measurement, and Evaluation*, at 58 (Addison-Wesley 1984).

## **II. PUBLIC PROCUREMENT SECURITIES IN THE PHILIPPINES**

### **A. General Discussion**

There are three (3) instances in R.A. 9184 when securities are specifically required in public procurement activities, namely:

1. in Section 27, on Bid Securities;
2. in Section 39, on Performance Securities; and
3. in Section 62, on Warranties.

With respect to Bid Securities, Section 27 of R.A. 9184 provides that:

[A]ll Bids shall be accompanied by a Bid security, which shall serve as a guarantee that, after receipt of the Notice of Award, the winning bidder shall enter into contract with the Procuring Entity within the stipulated time and furnish the required performance security. The specific amounts and allowable forms of the Bid security shall be prescribed in the IRR.<sup>6</sup>

The purpose of the Bid Security is to ensure or guarantee that the winning bidder, within a maximum period of ten (10) calendar days from receipt of the Notice of Award: (a) enters into contract with the procuring entity; and (b) furnishes the required performance security. If a bidder fails to submit the Bid Security in the form and amount prescribed, its bid shall automatically be disqualified.<sup>7</sup> Section 27.2 of IRR-A allows both the procuring entity and the bidder to choose among the following forms of Bid Security:

1. Cash, certified check, cashier's check/manager's check, bank draft/guarantee confirmed by a reputable local bank or in the case of a foreign bidder, bonded by a foreign bank;
2. Irrevocable letter of credit issued by a reputable commercial bank or in the case of an irrevocable letter of credit issued by a foreign bank, the same shall be confirmed or authenticated by a reputable local bank;
3. Surety bond callable upon demand issued by a reputable surety or insurance company;
4. Any combination thereof; or
5. Foreign government guarantee as provided in an executive, bilateral or multilateral agreement, as may be required by the head of the procuring entity concerned.

The same section also provides the required amount for each of the above forms of security, to wit:

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<sup>6</sup> R.A. 9184, Art. VIII, Sec. 27.

<sup>7</sup> See R.A. 9184, IRR-A, Rule VIII, Sec. 27.

| <b>Form of Bid Security</b>   | <b>Minimum Amount in % of Approved Budget for the Contract to be Bid</b> |
|---|--|
| Cash, certified check, cashier's check, manager's check, bank draft or irrevocable letter of credit | One percent (1%)   |
| Bank guarantee  | One and a half percent (1 ½%)  |
| Surety bond   | Two and a half percent (2 ½%)  |
| Foreign government guarantee  | One hundred percent (100%)   |

Due to the fact that R.A. 9184 and its IRR-A mandate that the BAC shall check the documents submitted by each bidder against a checklist of required documents to ascertain if they are all present, and that a non-discretionary "pass/fail" criteria shall be used, a bid security that does not meet the required form, minimum amount and validity period shall automatically be rated as "failed." In this regard, it is important to note that under the same law, the minimum allowable amount for the bid security is not based upon a percentage of the bidder's submitted bid price, but upon a percentage of the approved budget for the contract to be bid, as published by the procuring entity together with the bid notice/advertisement.<sup>8</sup> The obvious intention of this provision is to prevent bidders from determining the bid price of other bidders before the opening date, by surreptitiously making inquiries with institutions about the value of their bond applications. The pervasiveness of this practice is recognized, to the extent that even the checklist of supporting documents for bond applications issued by the General Insurance Group of the GSIS includes a caveat on bidder's/proposal bonds, to the effect that applicants are urged to increase the amounts of their bonds over the minimum amount required in order to safeguard the secrecy of their bids. At present, under R.A. 9184, since the procuring entity's approved budget for the contract is made known to the public, and all bid securities are based on this fixed amount, there is less room for collusion, leakage or unfair practices by or among bidders, or between bidders and public officials.

Should a bidder eventually win the contract, it shall be required to post a performance security in accordance with the form and amount specified in the bidding documents. This time, the purpose of the performance security is to guarantee the faithful performance of, and compliance by, the bidder with its obligations under the contract awarded.<sup>9</sup> Section 39.1 of IRR-A provides for the same forms of performance securities as those allowed for bid securities, except that the minimum amount shall be in accordance with the following schedule:

| <b>Form of Performance Security</b>   | <b>Minimum Amount in % of Total Contract Price</b> |
|---|--|
| Cash, certified check, cashier's check, manager's check, bank draft or irrevocable letter of credit | Five percent (5%)                                  |
| Bank guarantee  | Ten percent (10%)                                  |
| Surety bond   | Thirty percent (30%)                               |

<sup>8</sup> R.A. 9184, IRR-A, Rule VIII, Sec. 27.2.

<sup>9</sup> R.A. 9184, Art. XI, Sec. 39.

Foreign government guarantee

One hundred percent (100%)

These forms are practically identical to those provided in Sections 19 and 31 of the IRR of E.O. 40 which, in turn, are similar to the provisions of earlier procurement laws, rules and regulations, *i.e.* P.D. 1594 and its IRR for the procurement of civil works, and E.O. 262 and its IRR for the procurement of goods; except that the IRRs of E.O. 40 and R.A. 9184 provide in more specific terms that an irrevocable letter of credit would have to be issued by a commercial bank, and that there now exists no reference to surety bonds issued by the GSIS. The latter point is of specific interest. In particular, while previous laws, rules and regulations made reference to GSIS as one establishment that may furnish surety bonds, along with other surety and insurance companies duly accredited by the Office of the Insurance Commission, E.O. 40 merely provides for surety bonds issued by “a surety or insurance company duly accredited by the Insurance Commission,” with no reference to GSIS. Now, R.A. 9184 simply refers to “a reputable surety or insurance company.” Although the omission of any reference to GSIS in the latter laws is not intended to mean that GSIS surety bonds are no longer recognized for public procurement purposes, it is an obvious indication of the drafters’ intention to de-emphasize GSIS-issued surety bonds and highlight the option to seek the same form of bonds from other reputable surety and insurance companies. Apparently, this development was the product of a general sentiment among the members of the technical working group and the drafters of the law that GSIS surety bonds were particularly difficult to garnish – a subject matter that will be further discussed and analyzed in later pages of this Study.

It should be noted that the above-enumerated forms of securities are listed in the alternative and, as such, it is believed that in the absence of any specific wording in the law that limits the choice of securities to either the procuring entity or the bidder, the right to choose belongs to both. In effect, at the outset, the procuring entity has the right to enumerate in the bidding documents the forms of securities it would allow bidders to submit, and the bidders would have the right to choose which among the enumerated forms would be furnished to the procuring entity, or any combination thereof.

Finally, after a supplier or contractor performs its obligation under the procurement contract, it would have to post a warranty security with the procuring entity.<sup>10</sup> In particular, under Section 62.1 of IRR-A, for the procurement of goods, a warranty is required from the supplier for a minimum period of three (3) months, in the case of supplies, and one (1) year, in the case of equipment, after the performance of the contract. The obligation for the warranty has to be covered either by retention money in an amount equivalent to at least ten percent (10%) of every progress payment, or a special bank guarantee equivalent to at least ten percent (10%) of the total contract price, which amount or guarantee shall be released only after the lapse of the warranty period, provided the goods are free from patent and latent defects, and all the conditions of the contract are fully met.

For the procurement of infrastructure projects, Section 62.2 of IRR-A requires that the contractor assume full responsibility for the contract work from the time project

<sup>10</sup> See R.A. 9184, Art. XIX, Sec. 62.

construction commences up to final acceptance by the government. More importantly, even after final acceptance of the project by the government, the contractor may still be held responsible for structural defects and/or structural failure of the completed project within the following warranty periods from final acceptance, except those occasioned by *force majeure* and those caused by other parties:

1. Permanent Structures – Fifteen (15) years
2. Semi-Permanent Structures – Five (5) years
3. Other Structures – Two (2) years

During the above periods, the contractor shall be fully responsible for the safety, protection, security and convenience of his personnel, third parties, and the public at large, as well as the works, equipment, installation and the like to be affected by his construction work. For this purpose, the contractor shall be required to put up a warranty security in the form of cash, bank guarantee, letter of credit, GSIS or surety bond callable on demand, in accordance with the following schedule.<sup>11</sup>

| <b>Form of Warranty</b>             | <b>Minimum Amount in % of Total Contract Price</b> |
|-------------------------------------|--|
| Cash, cash bond or letter of credit | Five percent (5%)                                  |
| Bank guarantee                      | Ten percent (10%)                                  |
| Surety bond                         | Thirty percent (30%)                               |

The consultants who prepared the design or undertook construction supervision for the project are also covered by the requirement for a warranty security, because they may be held liable where structural defects and/or failures arise due to faulty and/or inadequate design and specifications as well as construction supervision.

Of the various forms of securities available to bidders, winning bidders, suppliers, contractors and consultants, the Study will primarily focus on irrevocable letters of credit, bank guarantees and surety bonds.

### **B. Letters of Credit**

Article 567 of the Code of Commerce defines letters of credit as those issued by one merchant to another or for the purpose of attending to a commercial transaction. To be more precise, it has been defined as a letter from a merchant bank or bank or banker in one place, addressed to another, in another place or country, requesting the addressee to pay money or deliver goods to a third party therein named, the writer of the letter undertaking to provide him the money for the goods or to repay him.<sup>12</sup> This definition and the relevant provisions of the Code of Commerce, however, refer to regular letters of credit, as distinguished from standby letters of credit – the former pertaining to instruments issued in the course of commerce, trade, mercantile pursuits or the movement of goods, while the latter referring to an accommodation from a bank to assume or secure the liabilities/obligations of third parties in case of the latter's inability to perform an undertaking, such as that of

<sup>11</sup> R.A. 9184, IRR-A, Rule XIX, Sec. 62.2.

<sup>12</sup> Hector S. de Leon, *The Philippine Negotiable Instruments Law (and Allied Laws) Annotated*, p. 496 (Rex Book Store 1993).

submitting a bid, performing a contract or fulfilling a warranty. Based on these distinct definitions, it is obvious that R.A. 9184 and its IRR-A actually refer to “standby” letters of credit when providing for the various modes of bid and performance securities.

Under R.A. 8791, a commercial bank has the power to accept draft, issue letters of credit and such other powers as may be necessary to carry on the business of commercial banking.<sup>13</sup> In furtherance to this, Section X347 of the Manual of Regulations for Banks provides that domestic standby letters of credit may be issued or used in transactions other than those involving movement of goods under the following guidelines:

1. The bank’s obligation to pay shall be either unconditional (as against presentation of a clean draft) or conditional only upon the presentation of documents and not upon actual existence or non-existence of facts, *i.e.* the bank must not be called upon to determine disputed questions of facts or law;
2. The bank’s obligation shall be limited to a fixed maximum amount;
3. The bank’s obligation shall have an expressed expiration date;
4. The standby letters of credit accommodation shall not violate any law or existing BSP directives, rules and regulations, such as the SBL and DOSRI ceilings;
5. The party who opened the standby letters of credit or the ultimate borrower shall not have any past due obligation with the issuing bank for the ninety (90)-day period preceding the date of issuance of the letter of credit;
6. Drawings shall be honored only upon failure of the party who opened the letter of credit (borrower or principal obligor) to pay the amortization(s) due and upon presentation of a written certificate to this effect;
7. The party who opened the letter of credit (borrower or principal obligor) must have an unqualified obligation to reimburse the bank on the same condition as the bank has paid; and
8. Banks shall not issue standby letters of credit in favor of another bank to secure the obligation of the latter’s client or for the faithful performance by the client of his obligation to said bank.

The total standby letters of credit, foreign and domestic, including guarantees, the nature of which requires the guarantor to assume the liabilities/obligations of third parties in case of their inability to pay, that may be issued by a bank and outstanding at any given time, shall not exceed fifty percent (50%) of the bank’s unimpaired

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<sup>13</sup> R.A. 8791, Art. II, Sec. 29.

capital and surplus, except those fully secured by cash, hold-out on deposits/deposit substitutes or government securities.<sup>14</sup> Banks are also required to submit a monthly report of domestic standby letters of credit opened and outstanding within fifteen (15) banking days after the end of the reference month to the appropriate supervising and examining department, which report shall contain the following minimum information:

1. Date the letter of credit was opened;
2. Amount, purpose and accountee thereof;
3. Beneficiary;
4. Security and value of security;
5. Expiry date of the letter of credit; and
6. Certification as to the correctness of the report by an authorized officer of the bank.<sup>15</sup>

Similar to regular letters of credit which are based solely upon documents and provide for no discretion in the bank or trust company to waive any requirements,<sup>16</sup> a bank's obligation to pay under a standby letter of credit is conditioned only upon the presentation of documents and not upon actual existence or non-existence of facts – that is if it is not itself an outright unconditional standby letter of credit. It is a settled rule in law that a letter of credit, whether regular or standby, is a complete agreement in itself and is independent of the contract between the obligor and the obligee. As such, because the bank in a standby letter of credit is not a party to the original contract, it only deals with documents. In fact in actual practice, to satisfy a claim, some banks merely require the claimant agency to submit a notarized certification advising it of the default, and a confirmation from the defaulting party may not even be required.<sup>17</sup>

It is for the above reason that, according to Mrs. Lydia de Asis, Assistant Department Manager at the International Trade Department of the Land Bank of the Philippines (LBP), it is possible for LBP to satisfy a claim within one (1) day, provided that the required documents are in order and that the claim is submitted before the bank's cut-off time at 12:00 noon. However, according to Mrs. de Asis, LBP strictly inspects the documentary submissions to determine the existence of any discrepancy, so that if any deviation from the terms of the letter of credit is discovered, the claim will not be approved. A discrepancy that may lead to disapproval may pertain to a simple deviation in words or terms, such as in the address or name of the obligor. It is also worth noting that, based upon the personal account of Mrs. de Asis, while LBP averages fifty (50) applications for standby letters of credit a year, no claims have yet been made for the last two (2) years.

An applicant for a standby letter of credit is normally required by the bank to open a credit line with it, supported by a collateral with an appraised value amounting to a percentage of the amount applied for – in the case of LBP, this value is

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<sup>14</sup> Manual of Regulations for Banks, Sec. X347.2.

<sup>15</sup> *Id.*, Sec. X347.3.

<sup>16</sup> Feati Bank and Trust Company v. Court of Appeals, 196 SCRA 576 (1991), citing Anglo-South American Trust Co. v. Uhe, et al., 184 N.E. 741 (1933).

<sup>17</sup> Based on the interview of Mrs. Lydia de Asis, Assistant Department Manager, International Trade Department, Land Bank of the Philippines, conducted by Jose Luis C. Syquia (May 11, 2004).

approximately eighty percent (80%).<sup>18</sup> In case of some commercial banks, such as Metropolitan Bank and Trust Company (Metrobank), the value of the required collateral may range from fifty percent (50%) to seventy percent (70%) of the amount applied for, although in cases where the bank makes a unilateral determination that the applicant is a large corporation with a known and sound credit background, the collateral requirement may actually be waived.<sup>19</sup> Otherwise, the applicant may simply apply for a cash letter of credit, that is one backed up by actual cash equal to one hundred percent (100%) of the amount applied for.<sup>20</sup> Before a person could apply for a letter of credit or a any form of guarantee, he would have to be a depositor, because banks – as a matter of policy – normally only accommodate those whom they are familiar with or who have an established credit background. An exception to this would be cash letter of credit because, quite obviously, the applicant would back it up by actual cash equal to one hundred percent (100%) of the amount applied for. The maximum lifetime of a standby letter of credit is one (1) year.

The following are the fees that may be charged by a bank for the issuance of a letter of credit:

- Opening Fee - 1/8 of 1% of the amount of the letter of credit per month, provided that the minimum charge is One Thousand Pesos (PhP1,000.00), and the minimum validity period of the letter of credit is two (2) months
- Cable - Eight Hundred Pesos (PhP800.00)
- Notarization - One Hundred Pesos (PhP100.00)
- Miscellaneous - Thirty-five Pesos (PhP35.00)
- Documentary Stamps - Thirty Centavos (PhP.30) for every Two Hundred Pesos (PhP200.00)

### **C. Bank Guaranties**

Practically, the only difference between standby letters of credit and bank guarantees lies in their designation, because they both have the same purpose, that is to secure the liabilities or obligations of third parties, and they both entail similar procedures and requirements for application and claims.

Guarantee in its common acceptation means undertaking to answer for payment of some debt or performance of some duty of another, in case of failure of such other to pay or perform.<sup>21</sup> In the strict sense of the word, “guaranty” or “guarantee” applies to an undertaking by another, though it is sometimes used in the sense of “warranty” or “warrant.”<sup>22</sup>

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<sup>18</sup> *Id.*

<sup>19</sup> Based on the interview of Mr. Gregory M. Villanueva, Branch Head, Metropolitan Bank and Trust Company, Aguirre-Salcedo Branch, conducted by Jose Luis C. Syquia (May 20, 2004).

<sup>20</sup> *Supra* note 17.

<sup>21</sup> *Words and Phrases Permanent Edition*, Vol. 18, p. 789 (West Publishing Co. 1940), citing *Gravelle v. Pollock Stores Co.*, 267 P. 473, 474, 131 Okl. 20.

<sup>22</sup> *Id.*, citing *Field v. Lamson & Goodnow Mfg. Co.*, 38 N.E. 1126, 1128, 162 Mass. 388, 27 L.R.A. 136, citing *Wiley v. Inhabitants of Athol*, 23 N.E. 311, 150 Mass. 434, 6 L.R.A. 342.

In this jurisdiction, the general law on guaranty may be found in Title XV, Book IV of R.A. 386, otherwise known as the “Civil Code of the Philippines.” Article 2047 of the Civil Code defines guaranty as one whereby a person, called the guarantor, binds himself to the creditor to fulfill the obligation of the principal debtor in case the latter should fail to do so. The same Article further provides that if a person binds himself solidarily with the principal debtor – meaning a relationship whereby either of them is bound to render entire compliance of the obligation – the contract shall be called a suretyship. Under the Civil Code, the guarantor may bind himself for less, but not for more than the principal debtor, both as regards the amount and the onerous nature of the conditions, and he cannot be compelled to pay the creditor unless the latter has exhausted all the properties of the debtor and has resorted to all the legal remedies against the debtor.<sup>23</sup> The contract of a guarantor is a separate contract and in the nature of a warranty by him that the thing guaranteed to be done by the principal shall be done. In this regard, the guarantor is bound only to answer for the consequences of the principal’s default. This characteristic of a guarantee is important in distinguishing it from a surety, because although both answer for the debt, default or miscarriage of another, they are distinct in that the contract of a guarantor is collateral and secondary, while the obligation of a surety is original, primary and direct. A “guarantor” and a “surety,” though alike in that both are bound for another, differ from each other, because the obligation of the guarantor is secondary, a guarantor undertaking to pay if by due diligence the debt cannot be collected of the principal, while the obligation of a surety is primary, and the surety is bound equally and absolutely with the principal and is a debtor from the beginning.<sup>24</sup> For easy reference, the following are the basic distinctions between a suretyship and a guarantee:

1. The surety assumes liability as a regular party to the undertaking, while the liability of the guarantor depends upon an independent agreement to pay if the primary debtor fails to pay;
2. The surety is primarily liable, while the guarantor is secondarily liable; and
3. The surety is not entitled to the benefit of exhaustion of the debtor’s assets, while the guarantor has this right to have all property of the debtor and legal remedies against him first exhausted before he can be compelled to pay the creditor.<sup>25</sup>

Interestingly, with respect to item 3 above, in a bank guarantee format issued by a commercial bank in the Philippines, the following paragraph appears:

GUARANTOR waives the benefits of the excussion of the properties of, and the exhaustion of the legal remedies against the CLIENT.

A bank guarantee with this particular provision seems to grant the obligee the best of both worlds, because it provides for the benefits of an easier claim as compared to

<sup>23</sup> R.A. 386, Book IV, Title XV, Arts. 2054 and 2058.

<sup>24</sup> *Supra* note 21, at 797, citing *Schweitzer v. Fishel*, 13 Haw. 690.

<sup>25</sup> Cesario P. Tiopianco, *Commentaries and Jurisprudence on the Insurance Code of the Philippines*, p. 138 (Omniscience Publishing, Inc. 1999).

that involved in surety bonds and, at the same time, grants one of the primary advantages of a suretyship – the waiver by the guarantor to demand that the obligee first exhaust all remedies against the obligor.

It also has to be pointed out that the law regards a contract of guarantee or suretyship in *strictissimi juris*, and one in which the guarantor has the right of prescribing the exact terms upon which he will enter into the obligation, and to insist on his discharge if those terms are not observed. It is not a question whether he is harmed by a deviation to which he has not assented.<sup>26</sup>

As in the case of a standby letter of credit, an applicant for a bank guarantee is normally required by the bank to open a credit line with it, supported by a collateral with an appraised value amounting to a percentage of the amount applied for. As already discussed earlier, the required value may actually range from fifty percent (50%) to eighty percent (80%) of the amount applied for, and may actually be waived in some instances. Moreover, quite similar to a cash letter of credit, one may simply apply for a bank guarantee supported by his deposits in the same bank, the only difference being that in the case of the former, the applicant would provide the actual cash to back up the letter of credit, while in the case of the latter, there already exists a deposit that would be used to support the bank guarantee.<sup>27</sup>

It usually takes about one (1) month for a bank to approve an application for a bank guarantee, because it would have to undertake the credit process, such as that for credit investigation and appraisal of properties.<sup>28</sup> Prior to the issuance by the bank of the guarantee, the bank and its client would have to execute an Indemnity Agreement in order to provide for the above-mentioned collateral arrangement, the guarantee fee, representations and warranties, provisions for payment by the client or guarantor, reimbursements and interests, remedies of the guarantor prior to payment, application of payments, events of default and expenses of contracts, among others. Once a guarantee is finally issued, the bank as guarantor normally warrants that it shall pay the amount due the obligee, notwithstanding any contest or objection thereto by the bank's client, solely upon the sworn statement of the obligee that the bank's client has defaulted in any of its obligations, that the amount stated therein represents payment due and unpaid by the said client under its contract with the obligee, and upon receipt by the bank of any or all of the following supporting documents:

1. Statement of Account of the client; and/or
2. Invoices, delivery receipts or the like.

The following are the fees that may be charged by a bank for the issuance of a bank guarantee:

- Application Fee - Five Hundred Pesos (PhP500.00)
- Cancellation - Three Hundred Pesos (PhP300.00)
- Documentary Stamps – Fifteen Pesos (PhP15.00)

<sup>26</sup> *Id.*, at 801, citing Schoonover v. Osborne, 79 N.W. 263, 264, 108 Iowa, 453.

<sup>27</sup> *Supra* note 19.

<sup>28</sup> *Id.*

In addition to the relevant provisions of the Civil Code of the Philippines, R.A. 8791 and the Manual of Regulations for Banks issued by the BSP provide for strict rules regarding the authority of banks to grant credit line facilities. In relation to this, considering that an applicant for a standby letter of credit or a bank guarantee is normally required by a bank to open a credit line with it, it follows that only banks that are authorized to grant credit lines would be capable of issuing standby letters of credit and bank guarantees. As such, Section X348.1 of the Manual of Regulations for Banks provides that:

[A] bank with a net worth of at least PhP1 billion as defined in Section X106, may provide a committed credit line facility to a commercial paper issuer.

Consequently, referring to the above-cited Section X106.1 of the Manual of Regulations for Banks, it would be noted that only an Expanded Commercial Bank, otherwise known as a Universal Bank, which is covered by a minimum capital requirement of Four Billion Pesos (PhP4 Billion), and a Commercial Bank, which is covered by a minimum capital requirement of Two Billion Pesos (PhP2 Billion), would be considered qualified to grant a credit line facility. The other classifications of banks under the Manual of Regulations for Banks, namely: (1) Thrift Banks, composed of Savings and mortgage banks, Stock savings and loan associations, and Private development banks; (2) Rural Banks; and (3) Cooperative Banks; are not qualified to credit lines, because they do not meet the required minimum capital requirement.

Sections 23 and 29 of R.A. 8791 and Section X101 on the Scope of Banking Authorities in the Manual of Regulations for Banks, further provide that Expanded Commercial/Universal Banks and Commercial Banks have the power to issue letters of credit.

In contrast with R.A. 8791, under the old banking law, R.A. 337, banks were generally classified into three (3) major categories only, namely: (1) Commercial Banks; (2) Thrift Banks; and (3) Rural Banks. As such, pursuant to Section 21 of the old banking law, out of these three (3) major categories, only Commercial Banks had the power to issue letters of credit. Obviously, the basic difference between the new banking law (R.A. 8791) and the old banking law (R.A. 337) with regard to the authority of banks to issue letters of credit, is the fact that Expanded Commercial/Universal Banks were added by the former among the classification of banks and those authorized to issue letters of credit.

#### ***D. Surety Bonds***

##### General Considerations

The term “bond” is sometimes used as a generic term – as a written instrument by which a person has become bound or committed legally. Usually the word is taken

to mean a secondary or accessory securing a primary obligation in favor of some third person.<sup>29</sup>

In Philippine law, a contract of suretyship is an agreement whereby a party called the surety guarantees the performance by another party called the principal or obligor of an obligation or undertaking in favor of a third party called the obligee.<sup>30</sup> Under Section 2 of the Insurance Code of the Philippines, a contract of suretyship is deemed to be an insurance contract if made by a surety who or which, as such, is doing an insurance business. In this regard, the term “doing an insurance business” or “transacting an insurance business” includes making or proposing to make, as surety, any contract of suretyship as a vocation and not as merely incidental to any other legitimate business or activity of the surety.<sup>31</sup> There are, however, distinctions between a general insurance and a suretyship, namely:

1. An insurance policy is a two-party agreement between the insured and the insurance company, whereas a surety bond involves three parties.
2. An insurance policy represents the entire contract between the two interested parties, and all rights under it are limited to the terms and conditions as therein set forth. A surety bond, however, is commonly a collateral instrument, guaranteeing performance by the principal of the terms of another agreement, and the bond remains in full force and effect until the terms of the agreement are fulfilled. The bond in many instances cannot even be cancelled because of failure to pay the premium.
3. Insurance is a contractual relationship which exists when one party, for a consideration, agrees to reimburse another for loss caused by designated contingencies. It is based upon the sharing by many of the losses of the relatively few and the premium is the whole consideration for the insurance contract. In suretyship, however, theoretically no losses are expected and the premium charge is in effect, only a service fee for the extension of credit by the surety. Losses, of course, do occur, but in that event the surety usually has the right of subrogation, or salvage, in its effort to recoup its loss from the defaulting principal since the principal is primarily liable.<sup>32</sup>

Under Section 185 of the Insurance Code of the Philippines, a corporation formed or organized to guarantee the performance of or compliance with contractual obligations or the payment of debts of others shall be known as an “insurance corporation.”

Having laid the definitions of “doing an insurance business” and “insurance corporations,” which clearly cover suretyship contracts and those engaged in issuing surety bonds as a profession, Section 186 of the Insurance Code of the Philippines

<sup>29</sup> *Words and Phrases Permanent Edition*, Vol. 5, p. 648 (West Publishing Co. 1940), citing *State v. Leo*, 32 So. 447, 452, 108 La. 496.

<sup>30</sup> Insurance Code of the Philippines, Sec. 175.

<sup>31</sup> *Id.*, Sec. 2.

<sup>32</sup> Tiopianco, *supra* note 25, at 137.

further provides that no person, partnership or association shall transact any insurance business in the Philippines, unless possessed of the capital and assets required of an insurance corporation doing the same kind of business in the Philippines and invested in the same manner, nor unless the Insurance Commissioner of the Philippines shall have granted to him or them a certificate to the effect that he or they have complied with all the provisions of law which an insurance corporation doing business in the Philippines is required to observe. The same Section further provides that:

[E]very person, partnership, or association receiving any such certificate of authority shall be subject to the insurance laws of the Philippines and to the jurisdiction and supervision of the Commissioner in the same manner as if an insurance corporation authorized by the laws of the Philippines to engage in the business of insurance specified in the certificate.

Section 176 of the Insurance Code of the Philippines provides that the liability of the surety or sureties shall be joint and several with the obligor and shall be limited to the amount of the bond, and that this liability is determined strictly by the terms of the contract of suretyship in relation to the principal contract between the obligor and the obligee. It is interesting to note that this provision on liability is in consonance with the provisions of the Civil Code on suretyship and solidary liability discussed earlier, because the phrase “joint and several” actually has the same meaning as the term “solidary.” In fact, the Insurance Code of the Philippines itself provides that the pertinent provisions of the Civil Code shall be applied in a suppletory character whenever necessary in interpreting the provisions of a contract of suretyship.<sup>33</sup> It is important to note that when the obligation or liability is solidary on the obligor’s side, the obligee may collect from any of the solidary obligors the full amount of the obligation.

It should also be noted at this point that there are various and separate references to bidders’ bonds, performance bonds and surety bonds.<sup>34</sup> However, the IRR-A of R.A. 9184 makes a specific reference to surety bonds as a form of bond that may be furnished to an agency as bid security, performance security or warranty. Some agencies have confused a surety bond that is furnished as a bid security or as a performance security, on one hand, with a bidder’s bond or performance bond, upon the other, using these interchangeably and believing that there exists no distinction between them.

According to Engr. Antonio V. Molano, Jr., Director IV of the DPWH Bureau of Research and Standards, based on experience, there exists a slight distinction between a surety bond that is furnished as a bid security and a bidder’s bond. Accordingly, while the latter provides the applicant with the option of paying the premium only if he wins the bid, in the case of the former, the applicant has to pay the premium before the bond becomes effective. However, this distinction made by Engr. Molano is categorically denied by Ms. Ma. Cristina G. Melicor of the Suretyship Department, General Insurance Group, of the GSIS. According to her, as far as

<sup>33</sup> See *id.*, Sec. 178.

<sup>34</sup> Based on the interview of Atty. Arnulfo Q. Canivel, Manager of the Claims Department, General Insurance Group, conducted by Jose Luis C. Syquia (May 6, 2004); see also *Requirements for Underwriting and Claims Applications* (May 4, 2004) <[http://www.gsis.gov.ph/general\\_insurance/genins\\_requirements.html](http://www.gsis.gov.ph/general_insurance/genins_requirements.html)>.

GSIS is concerned, a bidder is always required to pay the premium for the bidder's bond, whether or not he is awarded the contract, because it is considered as a service charge by the surety or insurance company upon the said bidder. To clarify matters, according to Ms. Melicor of GSIS, the term "surety bond" is actually used in its generic form that may mean either a bidder's bond, performance bond or a guarantee bond. This view is shared by Atty. Jose Domingo L. Aizpuro, Assistant Head/Manager of the Surety Department of Malayan Insurance Company, Inc., who, however, adds that the matter would eventually depend on the intention of the parties or on the obligation involved.<sup>35</sup> This appears to be consistent with the basic definition of a surety bond as one that guarantees to the obligee that the principal named in the bond will perform certain obligations and if he fails to do so the surety will perform the obligation or pay the damages up to the amount of the bond. With this generic definition, the specific types of surety bonds to be issued, *i.e.* bidder's bond, performance bond or guarantee bond, would actually depend on the particular obligation involved, that is:

- A bidder's bond is required when a job, whether for construction or supply or other undertaking, is opened for competitive bidding, so that its function is to guarantee the good faith of the bidder;
- A performance bond is put up by the bidder in an auction sale or in any bidding guaranteeing the faithful performance of his obligations; and
- A guarantee bond is used to guarantee against defects for a given period of time after performance in a construction or supply contract.

At any rate, at the least, it may be said that Engr. Molano's observation regarding the payment of premium as a condition to the effectivity of a surety bond is consistent with Section 177 of the Insurance Code of the Philippines, which provides as follows:

Sec. 177. The surety is entitled to payment of the premium as soon as the contract of suretyship or bond is perfected and delivered to the obligor. No contract of suretyship or bonding shall be valid and binding unless and until the premium therefor has been paid, except where the obligee has accepted the bond, in which case the bond becomes valid and enforceable irrespective of whether or not the premium has been paid by the obligor to the surety: *Provided*, That if the contract of suretyship or bond is not accepted by, or filed with the obligee, the surety shall collect only reasonable amount, not exceeding fifty *per centum* of the premium due thereon as service fee plus the cost of stamps or other taxes imposed for the issuance of the contract or bond: *Provided, however*, That if the non-acceptance of the bond be due to the fault or negligence of the surety, no such service fee, stamps or taxes shall be collected.

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<sup>35</sup> Based on the interview of Atty. Jose Domingo L. Aizpuro, Jr., Assistant Head/Manager, Surety Department, Malayan Insurance Company, Inc. (June 16, 2004).

The above provision shows that, as a general rule, payment of the premium for a surety bond not only affects the effectivity of the contract of suretyship, but its validity as well. More importantly, irrespective of the fine distinctions among the various types of bonds outlined above, since R.A. 9184 makes a specific reference to surety bonds as bid security, performance security or warranty, it is clear that the intention behind its provisions is to invoke the legal principles on suretyship, including the rights and obligations of a surety, *i.e.* one solidarily bound with the principal obligor to the contract.

The following is a checklist of supporting documents that may required by private insurance companies for purposes of evaluating bond applications.<sup>36</sup>

1. Articles of Incorporation/Articles of Partnership
2. Registration with the Department of Trade and Industry for 2004
3. License to Operate for 2004
4. Corporate Secretary's Certificate/Board Resolution authorizing the company officer to sign the bond and to bind the company
5. Audited Financial Statements for 2003/Income Tax Returns for 2003
6. Completed Projects indicating the value of the Principal's participation, the total project cost and the date of completion
7. On-going Projects indicating the value of the Principal's participation, the total project cost and the percentage of accomplishment
8. Bond Application Form and Co-signor's Information Sheet
9. List of Equipment and Suppliers
10. ID with Signature of all signatories to the bond
11. Original/Certified true copy of the Contract
12. Cash collateral
13. Certificate of Time Deposit with a nominated bank and Deed of Assignment
14. Corporate Secretary's Certificate/Board Resolution authorizing the company officer of the bank to sign the conforme portion in the Deed of Assignment
15. Certification from the bank that the deposit is free of lien and unencumbered
16. Residence Certificate for 2004

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<sup>36</sup> Based the list of requirements for bond applications issued by Malayan Insurance Company, Inc. (June 16, 2004).

The length of time it could take for an insurance company to act upon an application for a surety bond and issue the same may depend upon whether the bond applied for is simple or complex.<sup>37</sup> For a simple surety bond, such as a bidder's bond, it could take the insurance company only a day or two to issue the same, subject to the condition that the documents submitted are complete. For a complex surety bond or for those which require different wordings, the process could take longer, and the length of time would actually depend on a case to case basis. The rate of premium that may be charged for surety bonds depends upon the tariff imposed by the Insurance Commission.

The requirements that may be requested by an insurance company in case the government agency concerned decides to file a claim, as well as the steps that are normally undertaken, are as follows:

1. The obligee/applicant files a Notice of Claim, which could be in any form, *i.e.* a letter;
2. The insurance company informs/notifies the principal/client about the claim filed, so that the latter could rebut the filing thereof. Sometimes, the insurance company tries to mediate between the two (2) parties;
3. If the filing of the claim is pursued, the obligee/client is also required to submit the proof/basis of its actual loss, *i.e.* vouchers as proof of payment; and
4. The claim would then be processed.

It is interesting to note that, based upon an interview conducted with Malayan Insurance Company, Inc., a private non-life insurance company that caters to private companies, suppliers and contractors that participate in government projects, during the years 2002 and 2003, out of an average of four thousand (4,000) to five thousand (5,000) surety bonds issued per year, not even one percent (1%) of these were called upon.<sup>38</sup> The usual problems encountered in the filing of claims are those involving the validity of claims, whereby the claimant either fails to provide sufficient proof of loss, or files for an amount that differs from that specified by the obligor upon confirmation.<sup>39</sup>

Having earlier established the concept of solidarity in relation to the concept of suretyship, it is now appropriate to discuss the next issue that has been the subject of much discussion among government agencies – that is, whether surety bonds are truly “callable on demand.” First of all, as pointed out earlier, recent laws on bid and procurement securities no longer include any reference to GSIS issued surety bonds and, instead, highlight the option to seek the same form of bonds from other reputable surety and insurance companies. This was brought about by the prevailing view among agencies that GSIS surety bonds – despite their being termed “callable on demand” – are actually very difficult to garnish, and therefore are not really “callable on demand.” The general sentiment is that if a surety bond is

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<sup>37</sup> *Id.*

<sup>38</sup> *Id.*

<sup>39</sup> *Id.*

“callable on demand,” it implies that it should be immediately payable upon a claim being made therefor, but agencies have alleged having difficulties because court action is usually required before one can successfully claim against a surety or insurance company.

Addressing this issue actually involves having to address other interrelated issues pertaining to GSIS surety bonds, in particular, and the legal concept of surety bonds, in general. Therefore, a portion of this section is dedicated to further analyzing GSIS surety bonds, by reviewing the policies, rules and procedures of the GSIS on the application for surety bonds and the processing of claims, vis-à-vis the general laws on suretyship. The actual practice of the GSIS with respect to surety bond applications and claims would also be analyzed, these would be backed-up by figures and data gathered from interviews and the records of the GSIS, and compared with the general sentiment raised by agencies. Thereafter, a legal analysis will be made to further explicate the true nature of surety bonds.

### GSIS Surety Bonds

The following officers of the GSIS were interviewed for this portion of the Study:

|                                |   |
|--------------------------------|---|
| 1. Atty. Nora M. Saludaes      | Senior Vice President, General Insurance Group                          |
| 2. Atty. Salvador M. Allid     | Accounts Manager, Accounts Management Services, General Insurance Group |
| 3. Atty. Arnulfo Q. Canivel    | Manager, Claims Department, General Insurance Group                     |
| 4. Ms. Ma. Cristina G. Melicor | Chief, Suretyship Department, General Insurance Group                   |

The following is a checklist of supporting documents issued by the General Insurance Group of the GSIS for bond applications:<sup>40</sup>

1. Photocopy of Articles of Incorporation and By-laws with the latest amendments, if any; for single proprietorships, certificate of registration of business name; contractor's license.
2. Financial statements for the last two (2) years as certified by independent certified public accountant and, if available, the latest interim financial statements.
3. Certification of corporate secretary, duly notarized, of: (a) the present directors and principal executive officers of the corporation; and (b) present list of the shares of stock issued and outstanding indicating name of stockholders, number of shares held and total par value.

<sup>40</sup> *Requirements for Underwriting and Claims Applications* (May 4, 2004)  
<[http://www.gsis.gov.ph/general\\_insurance/genins\\_requirements.html](http://www.gsis.gov.ph/general_insurance/genins_requirements.html)>.

4. Certification of corporate secretary, duly notarized, that the official signing the bond and the Indemnity Agreement on behalf of the corporation is authorized to do so by its Board.
5. Accomplishment of: (a) Bond Application Form, if single proprietorship; or (b) Co-signor Statement Form, if corporation, by the authorized signing official who will also be required to sign the Indemnity Agreement in his personal and individual capacity, except if merely a career executive without personal holdings in the company.
6. Photocopy of Residence Certificate of the authorized signing official, and Income Tax Return.
7. For Bidder's/Proposal Bonds: Photocopy of Invitation to Bid/Invitation for Bids/Letter of Inquiry/Request for Quotations/Circular Proposals. (Applicants are urged to increase the amounts of their Bidder's Bond over the minimum amount required in order to safeguard the secrecy of their bids.)
8. For Performance/Surety Bonds: Photocopy of Letter/Notice of Award and Purchase Order or Contract including the Specifications and other documents which form part of the contract; if not feasible, pertinent portions thereof wherein the obligation to be guaranteed by the bond are stated.
9. Very brief history of the firm, as certified by the corporate secretary, or by the owner, if single proprietorship, citing:
  - a) For supplies contracts – its experience, particularly in similar or comparative work as the contemplated undertaking and giving a list of past and present supplies contracts specially with the government stating the amount, kind of supplies, etc. and the reliability of the manufacturer of the supplies that it has contracted to furnish and deliver to the obligee under the bond.
  - b) For service contracts – its experience, particularly in similar or comparative work as the contemplated undertakings and giving a list of past and present service contracts especially with the government stating the amount, kind of service, etc.
  - c) For construction, furnishing and installation contracts – summary of operations, including, list of projects completed indicating among others the name and address of the owner or prime contractor, class of work, with brief description of undertakings, year started, year completed, amount of contract.
10. Photocopy of land title of signatory, real estate property with Assessed Value exceeding the amount of bond (front and back should be photocopied).

The last item in the checklist pertains to the collateral of the signatory/co-maker that would be used as security in case the bond is forfeited or garnished. In case of non-risky bond applications, a mere photocopy of the land title is required, but if the bond

application were determined to be risky, an actual mortgage upon the property in favor of the GSIS would be required. The GSIS normally requires the Assessed Value of the property to be twice the amount of the bond.

The premium charged by the GSIS for the issuance of surety bonds depends on the rating standards issued by the Philippine Insurance Rating Association (PIRA). In this regard, Section 339 provides the following on rating organizations:

Every organization which now exists or which may hereafter be formed for the purpose of making rates to be used by more than one insurance company authorized to do business in the Philippines shall be known as a "*rating organization.*" The term "*rate*" as used in this title shall generally mean the ratio of the premium to the amount insured and shall include, as the context may require, either the consideration to be paid or charged for insurance contracts, including surety bonds, or the elements and factors forming the basis for the determination or application of the same, or both.

At present, the following rates are charged by the GSIS as premium:

- A flat rate of forty-five percent (45%) of the amount for bidders' bonds, whether for the procurement of goods or infrastructure projects;
- A rate of .55% of the amount for performance bonds in the case of infrastructure projects where the amount of the bond is Three Hundred Thousand Pesos (PhP300,000) and above; and
- A rate of .6% of the amount for guarantee bonds in the case of infrastructure projects where the amount of the bond is Five Hundred Thousand Pesos (PhP500,000) and above.

The rate of premium for performance and guarantee bonds varies in the case of goods procurement. Based on the experiences of agencies, some surety and insurance companies may charge rates ranging from .3% to .4% of the amount of the surety bond.

When a government agency seeks to apply for a claim upon a bond issued by the GSIS, it must submit a written Notice of Claim to the Claims Department, General Insurance Group. To be specific, the requirements for each type of bond are as follows:

- Bidder's Bond –
  1. Instructions to Bidders
  2. Copy of the bond
  3. Notice of Award/Purchase Order
  4. Bid Bond of second lowest bidder
  5. Demand letters to the principal
- Performance Bond –

1. Copy of the contract
  2. Notice to Proceed/Notice of Award
  3. Accomplishment Report of the principal
  4. Inventory of usable materials and equipment left at the jobsite
  5. Unpaid billings or retention money due the principal
  6. Demand letter of the obligee to the principal
  7. Reply of the principal to the demand letters
  8. Contract with the new contractor, if awarded
  9. Cost to complete the project by the new contractor
  10. Purchase Order
- Surety Bond –
    1. Copy of the contract
    2. Progress billing applied to the advance payment
    3. Demand letters to the principal
    4. Reply of the principal to the demand letters

The pre-processing of bond claims is undertaken by the Suretyship Division of the Underwriting Department. The Underwriting Department then endorses the claim to the Claims Department for processing, and it is in the Claims Department that the decision to approve or disapprove a claim is made.

All the required documents to apply for a claim will be evaluated during the Claims committee meeting, which is held regularly. This committee will either deny or approve the payment of the claim. Before payment is made by the GSIS, a demand letter will be sent to the principal obligor, advising him to settle the bond undertaking; otherwise, the terms and conditions of the Indemnity Agreement executed in favor of the GSIS will be enforced.<sup>41</sup>

Although a number of laws made specific reference to GSIS surety bonds as an option for bid and performance securities, according to GSIS, several agencies have not been respecting these laws. For example, DPWH and BOC do not make any specific reference to GSIS surety bonds in their bidding documents. Moreover, there are agencies that strike out surety bonds as allowable bid and performance securities altogether. This was confirmed by the proponent of this Study during the course of his interviews with other agencies, when officials of DepEd and DOH affirmed that they have not provided for surety bonds in their bidding documents since 2002 at the latest. A respondent from GSIS raised the view that this practice among agencies may run against laws and COA circulars requiring government interests to be insured with the GSIS. On the other hand, another respondent from the GSIS believed that allowing bidders to apply for surety bonds with other surety or insurance companies was favorable to GSIS, because it would make the public realize that GSIS surety bonds are safer and provide more security than most of those offered in the private sector. Of course, with the advent of R.A. 9184 and its IRR-A, this matter appears to be moot, because the law now clearly grants bidders, suppliers, contractors and consultants the right to apply for surety bonds from any

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<sup>41</sup> *Id.*

reputable surety or insurance company. At any rate, an interesting issue is brought to light, namely:

Whether or not recent figures and facts exist to support the claim that GSIS surety bonds, as distinguished from those issued by private surety and insurance companies, are difficult to forfeit or garnish.

When asked to comment on the perception among agencies that GSIS surety bonds are particularly difficult to forfeit, Atty. Canivel, Manager of the Claims Department, General Insurance Group of the GSIS, said that this view does not appear to be supported by the actual figures of the GSIS on claims filed against its bonds. In particular, based upon the logbook of claims presented by Atty. Canivel to the proponent, in 2002, out of 46 claims filed with his Department, nothing pertained to bidder's and performance bonds. Once again, in 2003, out of 12 claims filed with the same Department, nothing pertained to bidder's and performance bonds. According to Atty. Canivel, it appears from the records that the general perception against GSIS surety bonds may actually be based upon isolated transactions that occurred beyond the last two (2) years.

One such isolated transaction appears to be the experience of the DOH with respect the procurement of Ferrous Sulfate tablets under the Women's Health and Safe Motherhood Project, covered by a loan from the ADB and offered for bidding in May 1997. In this particular case, an award of contract was made by the DOH on September 26, 1997, in favor of MG Generics Inc. for the purchase of two million nine hundred twenty-nine thousand five hundred seventy-five (2,929,575) bottles of one hundred (100) Ferrous Sulfate micronutrient tablets, with the contract price of Fifty-one Million One Hundred Twenty-one Thousand Eighty-three Pesos and Seventy-five centavos (PhP51,121,083.75).<sup>42</sup> MG Generics Inc. posted the required performance bond and signed the contract with the DOH; the former being represented by its President and General Manager, Mr. Ramon Guiang, while the latter being represented by the Secretary of Health Dr. Carmencita Reodica.<sup>43</sup> During contract performance, MG Generics Inc. informed the DOH that it could only deliver thirty-three percent (33%) of the quantity expected because of the increasing exchange rate between the Philippine Peso and the U.S. Dollar.<sup>44</sup> As such, the DOH decided to forfeit the performance bond which, according to accounts from DOH officials, was issued by the GSIS. Unfortunately, it appears that the DOH failed to forfeit the performance bond, because the GSIS denied the claim.<sup>45</sup>

According to DOH officials, including Assistant Secretary Zenaida O. Ludovice, MD of the Office for Public Health Services, DOH, who was then a member and subsequently the chairperson of the PBAC on Foreign-Assisted Projects that undertook the above public bidding, the experience of the DOH on the performance bond of MG Generics Inc. weighed heavily on the decision of Honorable Manuel M.

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<sup>42</sup> *The Truth about the Ferrous Sulfate Issue*, Department of Health Press Conference held by Sec. Felipe A. Estrella, Jr., MD (September 8, 1998).

<sup>43</sup> *Id.*

<sup>44</sup> *Id.*

<sup>45</sup> Based on the interviews of Assistant Secretary Zenaida O. Ludovice, MD, Office for Public Health Services, DOH, Engr. Joel N. Lazo, Chief of the Procurement Division, DOH, and Ms. Minda Marie Y. Gugol, Buyer IV, DOH, conducted by Jose Luis C. Syquia (May 12, 2004).

Dayrit, the incumbent Secretary of Health as of this writing, to strike out surety bonds as one of the bid and performance securities that may be availed by bidders and suppliers. DOH Assistant Secretary Ludovice further pointed out that, according to Honorable Alexander A. Padilla, incumbent Undersecretary of the Department of Health and Chairperson of the DOH COBAC as of this writing, agencies have to be particularly cautious about GSIS surety bonds, and a government agency should not insure its interests with other government agencies, because:

1. In case of any dispute arising from a claim, a conflict of interest may arise out of the fact that both would eventually be represented by the Solicitor General's Office; and
2. In case of a successful claim upon a GSIS surety bond, for the reason that two (2) government agencies are involved, any recovery therefrom would merely entail the transfer of funds from one pocket to another pocket of the government.

When separately interviewed by the proponent, both Engr. Molano of the DPWH and Engr. Cipriano A. Ravanos, Jr., Executive Director of PWI, an NGO focused on combating graft and corruption in public procurement, concurred with the above points of DOH Undersecretary Padilla. These, in addition to the prevailing view among almost all government officials interviewed by the proponent – excluding those from GSIS – that GSIS surety bonds are very difficult to forfeit or garnish. However, it should be noted that the aforementioned case of the DOH falls beyond the two-year coverage of this Study. This case was included only because it was admittedly one of the major considerations regarded by the DOH in deciding on a policy level to remove surety bonds in general from among the allowable bid and performance securities.

As such, disregarding the DOH Ferrous Sulfate case which, as just mentioned, falls beyond the coverage of this Study, among all the agencies interviewed by the proponent, there appears to be no case within the last two (2) years involving a claim filed with the GSIS for the forfeiture of a surety bond. This appears to be in accord with the records presented to the proponent by Atty. Canivel of the GSIS.

In this regard, there seems to be no sufficient data within the last two (2) years to support a sweeping determination that GSIS surety bonds, as distinguished from those issued by private surety and insurance companies, are generally difficult to forfeit or garnish. It should be pointed out, however, that this conclusion is only meant to address allegations that tend to single out GSIS surety bonds from those issued by private surety and insurance companies, and may not necessarily be true for surety bonds in general.

On the other hand, a view was raised from undisclosed sources that some agencies have been refusing to recognize GSIS surety bonds, because they have allegedly been endorsing favored surety or insurance companies to bidders, suppliers or contractors. This allegation may not be too far-fetched, because personal experiences have been relayed to the proponent whereby surety and insurance companies would offer commissions to public officials who are able to refer bidders, suppliers or contractors to them in relation to procurement activities being

undertaken by the procuring entity to which these public officials belong. Based on these personal accounts, the commissions offered can reach up to ten percent (10%) of the amount of the premium paid by the bidder, supplier or contractor. For example, assuming that the approved budget for a particular contract being bid out is One Hundred Million Pesos (PhP100,000,000.00), if a bidder decides to furnish a surety bond to the procuring entity as bid security, the same would have to be in an amount equal to two and a half percent (2 ½) of the approved budget for the contract, or Two Million Five Hundred Thousand Pesos (PhP2,500,000). As such, assuming further that the premium charged by the surety company is .4% of the amount applied for, or ten thousand pesos (PhP10,000), the commission to be paid to the referring public official would be ten percent (10%) of that amount, or One Thousand Pesos (PhP1,000). It should be remembered that the offer to pay commissions is not applicable only to surety bonds issued as bid securities, but to all other types of bonds and insurance schemes that the surety or insurance company may end up issuing to a supplier or contractor during the course of the contract, in case he wins the same. The GSIS claims that it does not have the leeway to grant any such type of commission, being a government institution bound by strict audit rules.

Section 1 of Act No. 536, as amended by Act No. 2206, provides that whenever any bond conditioned for the faithful performance of any duty to or contract with any public authority is, by the laws of the Philippines or by the regulations of any public authority therein, required or permitted to be given with one or more sureties, the same may be executed or the performance of the condition guaranteed by **any corporation organized under the laws of the Philippines**, having power to execute and guarantee bonds and to agree to the faithful performance of any contract or undertaking made with any public authority. However, such bond should be approved by the head of department, officer, board, or body required to approve or accept the same. Moreover, the same provision requires that **no officer or person having the approval of any bond shall require that it shall be furnished by a guarantee company, or by any particular guarantee company**, and that no head of department, officer, board or body shall approve or accept any corporation as surety on any bond, contract or undertaking, **unless such corporation has been authorized to do business in the Philippines in the manner provided by the provisions of the same Act**, nor unless such corporation has by contract with the GOP been authorized to become a surety upon bonds and undertakings.

In line with the requirement of Act No. 536, as amended, that only duly organized and authorized surety companies shall have the power to execute and guarantee bonds for the faithful performance of any contract with the government, and that no officer or person is allowed to require that a bond be furnished by a particular company, it appears that the practice whereby some public officials refer bidders, suppliers or contractors to surety and insurance companies for a commission, runs against the general policy of the law – even if the bidding documents specifically do not provide for a specific surety or insurance company – because it would seem that the official concerned would be going against the spirit or principle behind the said prohibition.

Legal Analysis

Another interesting point can be raised with respect to Section 1 of Act No. 536, as amended, vis-à-vis the Philippines' current public procurement laws. Apparently, by deleting any specific reference to GSIS surety bonds in its bid and performance security provisions and by simply providing a reference to a "reputable surety or insurance company," it appears that R.A. 9184 and its IRR-A harmonized the rules on bid and performance securities with the existing public policy on bond issuance laid down in Act No. 536. But then a question could be raised as to what may be considered as a "reputable" surety or insurance company. To answer this, Sections 27 and 39 of R.A. 9184 and its IRR-A on bid and performance securities may be read in conjunction with Section 1 of Act No. 536, as amended, to mean that only those companies that are authorized to do business in the Philippines as a surety or insurance company or corporation, or have by contract with the GOP been authorized to become sureties upon bonds and undertakings, may be considered as "reputable" and authorized to issue surety bonds. This interpretation is in line with Section 175 of the Insurance Code of the Philippines, which provides that a contract of suretyship "includes official recognizances, stipulations, bonds or undertakings issued by any company by virtue of and under the provisions of Act No. 536, as amended by Act No. 2206." This view is also shared by Engr. Molano of the DPWH, Engr. Elmer H. Dorado, Division Chief of the NEDA, and Engr. Ravaness of PWI.

However, although recent laws have opened the market for surety bonds as bid and performance securities, the issue regarding the difficulty of garnishing this type of security still persists. It has already been shown earlier that in the last two (2) years, not enough data exists to say that GSIS surety bonds, as distinguished from those issued by private surety and insurance companies, are generally difficult to forfeit or garnish. This leads us to the next logical and obvious proposition – **that the difficulty alleged by government agencies with respect to surety bonds is one that is common to surety and insurance companies in general.** As such, the legal principles governing suretyships would have to be analyzed further, because any difficulty arising from the forfeiture of surety bonds may actually be the result of the intrinsic legal nature of a suretyship contract. This brings us back to the issue on whether or not surety bonds are really "callable on demand."

First of all, it may be useful to point out that the phrase "callable on demand," when used to describe surety bonds, appears to be consistent with the fact that the obligations of a surety and the obligor are solidary, because a contract of suretyship is a contract by which the surety becomes bound as the principal or original debtor is bound. As such, it is a primary obligation, and the surety is bound with his principal as an original promisor. Going back to the distinction between a guarantee and a surety, while a guarantor is an insurer of the solvency of the debtor or obligor, a surety is an insurer of the actual debt or obligation. In fact, in the usual form for the Performance Security: GSIS Bond, the following language appears:

That we, \_\_\_\_\_ represented by its  
\_\_\_\_\_, as Principal and the GOVERNMENT

SERVICE INSURANCE SYSTEM as Administrator of the General Insurance Fund, a corporation duly organized and existing under and by virtue of the laws of the Philippines, with head office as Manila, its SURETY, are held and firmly bound unto the \_\_\_\_\_ in the sum of PESOS \_\_\_\_\_ (PhP \_\_\_\_\_), Philippine Currency for the payment of which sum well and truly to be made, **we bind ourselves, our heirs, executors, administrators, successors and assigns, JOINTLY AND SEVERALLY**, firmly by these presents.

\* \* \* \* (Emphasis supplied)

Therefore, this analysis would have to revolve around the concept of solidary liability, because this is, in principle, the very essence of a suretyship contract – though not necessarily in fact. Being solidary in nature, the obligation of a surety is primary, and the surety is bound equally and absolutely with the principal and is a debtor from the beginning. Now, in principle, it appears that this type of security provides the obligee with the highest form of protection against default, because it assures him of recourse against the surety if the principal obligor does not perform. Note that the phrase used was “does not perform,” not “cannot perform.” For this reason, unlike an ordinary guarantor, the surety does not have the right to require the obligor to exhaust all the legal remedies against the debtor before he can be compelled to pay the creditor; and, as such, in theory, if the obligor refuses to perform under the contract, the obligee can immediately compel the surety to perform the entire obligation.

This seems enough to give one the impression that a surety bond should be immediately payable upon a claim being made therefor. However, once again, this situation may be true only in theory, because – in practice and in fact – obligees seeking to enforce a claim find themselves locked in litigation against the surety or insurance company.

Ironically, while the principle of solidary liability seems to give the impression that suretyship contracts offer the most protection to procuring entities, it may in fact be the root cause of the difficulties encountered by these obligees in garnishing surety bonds. For while it may be true that a surety is bound solidarily with the principal obligor and, as such, either one of them may be compelled to perform the entire obligation, it also implies that a surety is entitled to all the rights and defenses that the principal obligor may have against the procuring entity. In the same way that the principal obligor may resist to perform an obligation, so too may the surety resort to legal or judicial action to dispute a claim if, in the view of its Claims Department, the same should be denied.

Under Article 1222 of the Civil Code, there are three kinds of defenses available to a solidary debtor when sued by the creditor:

1. Defenses derived from the nature of the obligation;
2. Defenses personal to the debtor-defendant; and
3. Defenses personal to the other solidary obligors.

Defenses that are inherent in the obligation are those connected with the obligation and are derived from its nature – those which may contribute to weaken or destroy the juridical or legal tie (*vinculum juris*) existing between the obligee and the obligor – and constitute a total defense.<sup>46</sup> Examples of these are the non-existence of the obligation, nullity due to defect in capacity of consent of all the obligors, unenforceability because of lack of proper proof required by law, non-performance of a suspensive condition or non-arrival of a period affecting the entire obligation, prescription, or extinguishment of the obligation, such as by payment or remission. The defenses that are personal to the obligor being sued or subject of the demand, e.g., the surety, may either be those pertaining to sufficient causes that totally annul consent, such as fraud, violence of intimidation, or may take the form of special terms or conditions affecting only its part of the obligation, but not the other portions thereof for which it may still be liable. The defenses that are personal to the other obligors are those that may affect the capacity or consent of such obligors, or those that may only refer to terms or conditions affecting their shares – all of which are only partial defenses that exempt the surety from performing the portions of the obligation corresponding to the other solidary obligors who have such personal defenses.

In view of the foregoing, it is not surprising that a claim has to go through the entire procedure of pre-processing, endorsement, and then final processing and determination at the Claims Department, to verify if there are any valid defenses that the surety or insurance company can raise against the claimant – whether inherent in the obligation itself, personal to it, or personal to the principal obligor. This is in contrast to the procedure outlined earlier for garnishing standby letters of credit and bank guaranties, wherein the bank, not being a party to the original contract, only deals with documents, and whereby, in actual practice, some banks merely require the claimant agency to submit a notarized certification advising it of the default which need not even be confirmed by the defaulting party. The very fact that a surety is held primarily liable under the contract is sufficient incentive for it to demand more requirements from claimants and conduct a more critical review thereof. In fact, Ms. Melicor of GSIS affirmed the GSIS does not pay a claim immediately after it is made, because the Claims Department needs to look at both sides of the contract involved to determine whether the claim is indeed proper. For this reason, it appears that a surety bond is “callable on demand” only because the legal principle of solidarity generally grants the obligee the right to treat the surety as one that is primarily liable for the obligor’s obligation. However, for reasons discussed above, the actual “callability” of a surety bond would have to depend upon the propriety of a claim.

Clearly then, although the law gives the surety the same obligation as that of the principal obligor, it also gives him the same amount of defenses that are available against a claim. As such, it may be said that any difficulty experienced by an agency in claiming against a surety bond may not necessarily be the result of the internal practices, policies, rules and procedures of any particular surety or insurance company, nor that of any locally established business custom, but rather one that finds its roots in the very nature of a suretyship contract brought forth by well-entrenched laws and jurisprudence – both local and foreign. Therefore, any effort to address this difficulty, short of striking out surety bonds as bid and performance

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<sup>46</sup> Arturo M. Tolentino, *Commentaries and Jurisprudence on the Civil Code of the Philippines*, Vol. 4, p. 250 (Central Lawbook Publishing Co., Inc. 1991).

securities altogether, may actually entail amending established principles in law and jurisprudence, such as that on solidary obligations.

**III. SURVEY OF AGENCIES****A. The Department of Health (DOH)**

The following officers of the DOH were interviewed for the Study:

|                            |  |
|----------------------------|--|
| 1. Zenaida O. Ludovice, MD | Assistant Secretary, Office for Public Health Services |
| 2. Engr. Joel N. Lazo      | Chief, Procurement Division                            |
| 3. Minda-Marie Y. Gugol    | Buyer IV   |

The DOH allows bidders and suppliers to furnish the various types of bid and performance securities provided in R.A. 9184 and its IRR-A, with the exception of surety bonds. While letters of credit are allowed as performance securities for foreign-assisted projects, these are also not normally allowed as bid securities.

The decision to strike out surety bonds from the bidding documents of the DOH was made sometime in 2001, and, as pointed out earlier, was based upon difficulties it experiences with this type of security – the most prominent of which was with respect to its 1997 procurement of Ferrous Sulfate tablets under the Women's Health and Safe Motherhood Project, covered by a loan from the ADB. Two interesting arguments were also raised by DOH Undersecretary Padilla against government agencies and GSIS surety bonds, namely:

1. In case of any dispute arising from a claim, a conflict of interest may arise out of the fact that both would eventually be represented by the Solicitor General's Office; and
2. In case of a successful claim upon a GSIS surety bond, for the reason that two (2) government agencies are involved, any recovery therefrom would merely entail the transfer of funds from one pocket to another pocket of the government.

With surety bonds out of the picture, according to DOH officials, a manager's check appears to be the most favored type of bid and performance security for local projects, although there are those who furnish bank guaranties as well. In the case of foreign-assisted projects, according to these officials, bank guaranties and letters of credit are more common among suppliers.

In 2002 and 2003, the DOH had one (1) case where it called on a security, and this involved a manager's check. The International Competitive Bidding for the Supply and Delivery of Ferrous Sulfate Tablets and Vitamin-A was conducted in accordance with the World Bank Procurement Guidelines under its Early Childhood Development Project IFB No. WB-ECD-03-DOH-001.<sup>47</sup> The opening of bids for this procurement took place on July 14, 2003, and out of eleven (11) who secured the bidding documents, only six (6) bidders submitted proposals. The lowest complying bidder for Vitamin-A 100,000 IU as determined by the TWG was Savita Pharmaceuticals

<sup>47</sup> See DOH COBAC Resolution No. 053-2003, *Supply and Delivery of Vitamin-A 100,000 IU, IFB No. WB-ECD-03-DOH-001* (December 29, 2003).

(Savita) with a total contract price of Seventeen Thousand Seven Hundred Eighty-nine U.S. Dollars and Twenty-four Cents (US\$17,789.24), and a Notice of Award was issued in its favor and received by its local representative on October 6, 2003. The original performance security in the form of a stand-by letter of credit was received by the Procurement Division of the DOH on December 10, 2003, issued by the Bank of Baroda-New York, dated November 17, 2003. However, upon review, it was determined that the letter of credit received was not among the acceptable forms spelled out in the bidding documents. Moreover, it was also subsequently established that on December 11, 2003, in an Emergency Purchase for Personal Protective Equipment under Canvass No. 5-28-03 (12), conducted by the COBAC in accordance with GOP laws, the representative of Savita, Medicenares Traders (Medicenares), was imposed an administrative sanction of one (1) year suspension from participating in any bidding in the DOH from January 1, 2004 to December 31, 2004, for the following reasons:

1. Refusal to enter into contract with the government without justifiable cause, being adjudged as having submitted the Lowest Calculated Responsive Bid relative to Canvass No. 5-28-03 (12);
2. Refusal or failure to post the required performance security within the prescribed time in connection with Canvass No. 5-28-03 (12); and
3. Submission of eligibility requirements containing false information or falsified documents in connection with the BAC Resolution of CALABARZON.<sup>48</sup>

As such, under COBAC Resolution No. 053-2003, dated December 29, 2003, the DOH COBAC rescinded the award to Savita, based upon the following grounds:

1. Delay in return of and conveyance of false information relative to acknowledgement of the Notice of Award;
2. Delay in submission and unacceptability of the performance security; and
3. Suspension of the selected local representative, Medicenares Traders, per COBAC Resolution No. 051-2003, dated December 11, 2003.<sup>49</sup>

The COBAC further recommended to award the same item to Rusan Pharme Ltd., the second lowest calculated bid at a total contract price of Eighteen thousand Three Hundred Thirty-two U.S. Dollars and Fifty-five Cents (US\$18,332.55).

Although beyond the coverage of this Study, in 2004, the DOH again successfully forfeited a bid security in the form of a manger's check amounting to Sixty-five Thousand Pesos (PhP65,000.00). This case involved a public bidding for the Procurement of Markers, conducted in accordance with R.A. 9184 and its IRR-A,

<sup>48</sup> DOH COBAC Resolution No. 051-2003, *One (1) Year Ban on Medicenares Traders* (December 29, 2003).

<sup>49</sup> *Supra* note 47.

with the opening of bids occurring on January 9, 2004.<sup>50</sup> On the basis of the evaluation of the TWG, the lone bidder, Advance Paper Corporation (Advance), was found to be complying. A Notice of Award was subsequently issued in its favor and received by its representative on January 26, 2004. On January 29, 2004, Purchase Order No. 2004-1-019 for three hundred fifty thousand (350,000) pieces of Markers at Eighteen Pesos and Sixty Centavos (PhP18.60), for a total contract price of Six Million Five Hundred Ten Thousand Philippine Pesos (PhP6,510,000.00) was approved. However, after making partial deliveries on February 4 and 11, 2004, of Markers for four thousand five hundred (4,500) pieces and thirty-five thousand nine hundred ninety (35,990) pieces, respectively, Advance failed to deliver the remaining three hundred nine thousand four hundred fifty (309,450) pieces. Advance also failed to submit the required performance security. In view thereof, under COBAC Resolution No.07-2004, dated February 17, 2004, the DOH COBAC rescinded the award for three hundred fifty thousand pieces of Markers to Advance, based upon the following grounds:

1. Delay in submission of the performance security; and
2. Failure to deliver the goods as per commitment to the COBAC.

The COBAC further recommended the following:

1. To pay for the Markers Advance had already delivered;
2. To forfeit their bid security; and
3. To impose the administrative sanction of one (1) year suspension from participating in any bidding in the DOH, pursuant to the provisions of R.A. 9184.

According to Engr. Lazo, the DOH already deposited the managers' checks issued on behalf of Savita and Advance, respectively.

On the issue of whether or not bid and/or performance securities should be removed as a requirement in public procurement, the respondent DOH officials were not in favor of such a proposal. Based on experience, these officials believe that, given the opportunity, bidders would generally try to escape their obligations under a contract with the government. According to them this is, in turn, partly because these bidders are aware that government agencies are generally unable to pay on their contract within one (1) month, at the least. For this reason, given the realities faced by both parties to a government contract, a bid security tends to screen out bidders who merely try to cheat an agency by submitting extremely low prices but who actually have no capability or intention to fully deliver or perform. The two (2) aforementioned cases of the DOH seem to exemplify this situation or concern, keeping in mind that refusal of a bidder to accept an award or undertake the contract in good faith may entail heavy losses to an agency in terms of time, public services that have to be rendered and, particularly for foreign denominated contracts, foreign

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<sup>50</sup> See DOH COBAC Resolution No. 07-2004, *Rescission of Award for the Procurement of Markers, IFB No. 2004-1-9 (2)* (February 17, 2004).

currency exchange risks. As such, over and above the sanctions that may be imposed by an agency, according to DOH officials, bidders and suppliers need some form of risk when participating in government contracts to ensure that only those who are legitimate, capable and serious to undertake the contract, as well as those with good track record, will be involved. At the same time, bid and performance securities are generally more expeditious in providing indemnity or restitution for damages caused by a bidder or supplier, as opposed to other measures like resorting to an action in court.

DOH Assistant Secretary Ludovice also raised the following points or concerns regarding bid and performance securities:

- It has to be clarified that a certificate of bank deposit that is sometimes submitted by bidders or suppliers as bid or performance security, is not equivalent to a guarantee, because the former is not committed to the particular project or contract involved; and, as such, should be rejected.
- Agencies have to be vigilant in ensuring that the validity periods of bid and performance securities, particularly the one hundred twenty (120) calendar day limit for bid securities, do not expire prior to the fulfillment of the purpose for which these are furnished without an extension having been made.
- An issue arises regarding securities that are in the form of cash, certified checks, cashiers' checks and managers' checks. On one hand, there are agencies such as the DOH that deposit these securities with the National Treasury, because they are required by law to do so. As such, these securities are forwarded to the cashier who, in turn, deposits them. A problem, however, arises when bidders or suppliers finally request for the return of these securities. Apparently, for the reason that these securities enter into the General Fund of the GOP, a request for a Notice of Cash Allocation (NCA) from DBM is required under budget laws, such as P.D. 1177, before the same may be released to bidders or suppliers – a process that could take a considerable length of time. This length of time, in turn, results to higher prices, because the bidders or suppliers immediately input the expected cost of money for the expected period involved. On the other hand, there are agencies that seek to save on the time involved in obtaining NCAs, by simply placing these securities in a safety deposit box. This is regarded by some as contravening existing laws, rules and regulations. But a view was raised that no violation is committed, because until the agency involved forfeits these securities, it does not have any right to claim these as its own, and until that time, the same cannot be considered as income to the agency.
- There are instances in the procurement of foreign-assisted projects when the foreign bank issuing the security has no correspondent bank in the Philippines, or where the bid security is written in a foreign language and there is no attached official English translation.

**B. *The Department of Education (DepEd)***

The interviewee for this portion of the Study was Director Aida Carpennero, head of the Procurement Service of the DepEd.

Similar to the DOH, DepEd allows bidders and suppliers to furnish the various types of bid and performance securities provided in R.A. 9184 and its IRR-A, with the particular exception of surety bonds. However, unlike the DOH, DepEd has no provision for bid and performance securities in the form of cash.

With cash and surety bonds out of the picture, according to Dir. Carpennero, bidders and suppliers tend to prefer managers' checks and bank guarantees as bid and performance security for both local and foreign-assisted projects, although a few of bidders and suppliers submit letters of credit.

Interestingly, according to Dir. Carpennero, the DepEd has never called on a bid or performance security in 2002 and 2003. As such, the DepEd has no figures to show on the matter. However, according to Dir. Carpennero, her office is currently studying the possibility of filing a claim against a bank guarantee issued on behalf of one of its suppliers in a contract to deliver thirteen thousand two hundred seventy-one (13,271) pieces of Secondary Armchairs, under the World Bank's Social Expenditure Management Project (SEMP) No. SEMP-2001-11-22-VEXIM. In this particular case, the contract was awarded to Victoria Exports and Imports, Inc. (Victoria), and a Notice to Proceed was issued to it on June 11, 2003. Under the project, the last delivery was supposed to have been made on November 11, 2003, but upon request of the suppliers, the deadline was subsequently extended to December 2003. Despite this extension, Victoria failed to deliver, and although it claims to have made the last delivery, it has consistently failed to produce the documentary support to prove the same, such as the delivery receipts, the billing and the certificate of final acceptance. The performance security furnished by Victoria was a bank guarantee issued in its favor by a thrift bank called ISLA Bank. The DepEd is currently validating the claims of Victoria that it has made the final deliveries under the contract, and if it is established that the said delivery was not undertaken, according to Dir. Carpennero, her office would recommend calling upon the bank guarantee. But a review of the bank guarantee issued by ISLA Bank revealed that the same expired on January 30, 2004, without any extension or renewal having been made.

The absence of a claim against any bid or performance security during the last two (2) years may either mean that the agency was very successful in its procurement practice, to the extent that only bidders who were proven to be competent and capable were awarded contracts and that the implementing officers properly managed the progress of the projects, or it may mean poor project management or excessive laxity on the part of the implementing agency. To illustrate, under the SEMP for year 2000, DepEd undertook procurement activities for school buildings, furniture and textbooks. Although these projects were bid out in 2000, the suppliers completed deliveries only in 2002, and payments have not yet been fully made to this date. Compare this to the subsequent experience of DepEd for its 2001 SEMP covering the same types of procurement, where contracts were bid out in November 2002, Notices to Proceed issued by June 11, 2003, and all deliveries – exception of the above-cited case of Victoria – were completed in December 2003. While the

latter only took a little over a year between the bid opening date and completion of deliveries, the former covered a span of two (2) years between bidding and full delivery – a difference that spans an entire year. Although Dir. Carpentero was not yet employed by the DepEd during the 2000 SEMP, she admits that DepEd is looking into the possibility that the delays experienced under that particular project may have been caused by poor management of deliveries. Moreover, according to her, this problem has been resolved by the DepEd for procurements covered by the 2001 SEMP through a detailed delivery schedule that requires the confirmation of all contracted suppliers. At any rate, considering the one (1) – year delay in the implementation of the 2000 SEMP, as well as the assessment that this may have been caused by delays in the deliveries of some suppliers; at the least, one would expect some action on the part of DepEd to call upon the performance securities of these suppliers. Although this is a matter that would have to be addressed internally by the DepEd, and is now, in fact, part of a management audit, it brings to light an issue or concern related to the effectiveness of bid and performance securities – that is, the effectiveness of the agency itself to successfully utilize these securities.

With respect to the issue of whether or not bid and/or performance securities should be removed as a requirement in public procurement, Dir. Carpentero opined that this may probably be seriously considered by the government only when the integrity and discipline of bidders have finally been established as a general rule. For her, at present, one cannot say with sincerity that bidders in government projects generally possess these traits, because majority of them are not truly committed to the project, several of them joining only for the sake of joining. In light of the fact that both of the SEMPs undertaken by the DepEd were wrought with extensions of delivery time, with the earlier one suffering a delay of about two (2) years, it appears that there is sufficient basis in DepEd to support the claims of Dir. Carpentero. As such, she further asserts that removing bid and performance securities now will simply place the procuring agency at the mercy of unscrupulous bidders, suppliers and contractors. Performance securities provide additional protection and assurance to the government against defaulting suppliers and contractors.

Dir. Carpentero also discussed the following points with the proponent:

- If a bidder or supplier furnishes a certified, cashier's or manager's check as bid or performance security with the DepEd, these are rarely transferred over to the cashier and deposited into the General Fund of the GOP. In most instances, these are held by the BAC Secretariat and a receipt is issued. Dir. Carpentero expressed the view that the practice of DepEd does not violate any accounting law, rule or regulation because these checks are mere security and are not the agency's to deposit.
- If DepEd were to allow surety bonds as bid and performance security, Dir. Carpentero believes that it would be safer to have GSIS issue these because of the danger of illegitimate or fly-by-night bonding companies.

**C. The Department of Public Works and Highways (DPWH)**

The following officers of the DPWH were interviewed for the Study:

|                                 |   |
|---------------------------------|---|
| 1. Engr. Antonio v. Molano, Jr. | Director IV, Bureau of Research and Standards |
| 2. Atty. Maximillan Fernandez   | Legal Officer IV, Legal Service               |

The DPWH allows bidders, suppliers and contractors to furnish the various types of bid and performance securities provided in R.A. 9184 and its IRR-A, including surety bonds.

Based on experience, according to Engr. Molano, contractors tend to favor surety bonds as bid and performance securities, because it only requires the payment of a small amount as premium. However, based on the same account, with the exception of JBIC which allows surety bonds as performance securities, IFIs generally do not allow bidders, suppliers or contractors to furnish surety bonds, and normally only allow the submission of letters of credit and bank guaranties. The DPWH does not limit bidders and contractors to GSIS issued surety bonds and, as such, these bidders and contractors tend to favor surety and insurance companies that can give lower premiums, as well as those that they are familiar with.

The DPWH could not provide the proponent with figures and estimates on the number of claims filed during the years 2002 and 2003; nor could it provide an estimated period – not even a range – for claiming surety bonds. However, the following were revealed:

- Bank guaranties are easy to garnish.
- According to one DPWH official, cash should not be removed as an allowable bid or performance security, because it is the easiest way for contractors to supplement securities.
- Although surety bonds are difficult to garnish, the DPWH Legal Service claims a high success rate of recovery. Accordingly, in several instances, the threat of blacklisting is sufficient to cause the surety or insurance company to pay on the bond. One such case was that involving the forfeiture of a surety bond amounting to Seven Million Pesos against Stronghold Insurance Company, sometime in 2000 and 2001.
- Before filing a suit against a surety or insurance company, the DPWH first issues it a demand letter. In several instances, the case is settled at this stage without having to go to court.
- The rescission of a contract is always regarded as a remedy of last resort, and performance securities are called only in that instance. In case of delays, a contractor is given the opportunity to submit a catch-up plan and liquidated damages are merely deducted from the progress billings.

With respect to the issue of whether or not bid and/or performance securities should be removed as a requirement in public procurement, the DPWH officials interviewed said that these should be maintained, otherwise the government would have no protection in case a contractor refuses to accept an award of defaults in its performance. For them, the sanctions provided by law are not sufficient deterrent against an erring bidder or contractor. It was further opined that bid and performance securities ensure the good faith of those who transact with the government. It was also believed that removing surety bonds as a form of bid and performance security would be favorable to the government, because other forms of security provide greater protection. The officials favored letters of credit and bank guarantees. However, since experience showed a high success rate in claims against surety bonds, it was also felt that it would not be objectionable to retain surety bonds as a form of bid and performance security.

The following points were also discussed:

- If a bidder, supplier or contractor furnishes cash, certified, cashier's or manager's check as bid or performance security with the DPWH, these are forwarded to the cashier and deposited in the bank to form part of the GOP's General Fund. As such, in case these have to be returned, the DPWH would request for an NCA before it could issue a voucher. This process may take up to three (3) to four (4) months.
- An inconsistency exists in the law with respect to the posting of a performance security. In particular, Section 39 of R.A. 9184 provides that a performance security would have to be posted by the winning bidder prior to the signing of the contract, which means that an accessory contract would have to be executed without any principal contract upon which it shall be attached. Although this was further clarified by Section 39 of IRR-A by providing that the performance security would have to be posted upon the signing of the contract, it was opined that the performance security should be furnished at a date that is even later than the perfection of contract, particularly after the issuance of the Notice to Proceed. This issue is now the subject of an ongoing case at the Regional Trial Court level involving a claim by the DPWH against a surety bond issued by Manila Insurance Company. Based on the interview of the proponent, a Motion to Dismiss was filed by the defendant insurance company against the complaint filed by the DPWH, on the ground that the suretyship contract was executed earlier than the date in which the principal contract was signed. It was further argued in the said Motion to Dismiss that, in the absence of a principal contract upon which the alleged suretyship contract could base its existence, the latter should be deemed void and nonexistent.
- The new provision of R.A. 9184 and its IRR-A on warranty of infrastructure projects after final acceptance may be not be practical, because it could last for as long as fifteen (15) years. As such, it does not seem to consider the realities of wear and tear and the expense upon the supplier to cover the same with sufficient securities. Moreover, it was opined that the contractor should no longer be held liable for the project once the government has inspected the same and issued its final acceptance thereof, because the contractor cannot be expected to continuously monitor the works for fifteen (15) years.

**IV. SURVEY OF SUPPLIERS**

For a more comprehensive understanding of all issues and views from all those involved in procurement, the stand of the government and the security issuers needs to be matched with the sentiments of those who contract with it. As such, in this Section, the views, experiences, preferences and sentiments of the suppliers were gathered through a survey that covered the basic issues and concerns of this Study. The survey questionnaires were either distributed through facsimile or answered through telephone inquiries, and the respondents were randomly chosen from all the suppliers registered with the Government Electronic Procurement System.

The survey questionnaire presented the following questions to be answered:

1. What type of Bid Security is most favored by your company? Why?
2. What type of Performance Security is most favored by your company? Why?
3. In your company's experience, what type of security is easiest to apply for? Why?  

|  |  |
|--|--|
| <input type="checkbox"/> Cash            | <input type="checkbox"/> Bank Guarantee            |
| <input type="checkbox"/> Cashier's Check | <input type="checkbox"/> Stand-by Letter of Credit |
| <input type="checkbox"/> Manager's Check | <input type="checkbox"/> Surety Bond               |
| <input type="checkbox"/> Certified Check | <input type="checkbox"/> Bank Draft                |
4. In your company's experience, what type of security is hardest to apply for? Why?  

|  |  |
|--|--|
| <input type="checkbox"/> Cash            | <input type="checkbox"/> Bank Guarantee            |
| <input type="checkbox"/> Cashier's Check | <input type="checkbox"/> Stand-by Letter of Credit |
| <input type="checkbox"/> Manager's Check | <input type="checkbox"/> Surety Bond               |
| <input type="checkbox"/> Certified Check | <input type="checkbox"/> Bank Draft                |
5. Do you favor Stand-by Letters of Credit? Why?  

|                              |                             |
|------------------------------|-----------------------------|
| <input type="checkbox"/> Yes | <input type="checkbox"/> No |
|------------------------------|-----------------------------|
6. Do you favor Bank Guarantees? Why?  

|                              |                             |
|------------------------------|-----------------------------|
| <input type="checkbox"/> Yes | <input type="checkbox"/> No |
|------------------------------|-----------------------------|
7. Do you favor Surety Bonds? Why?  

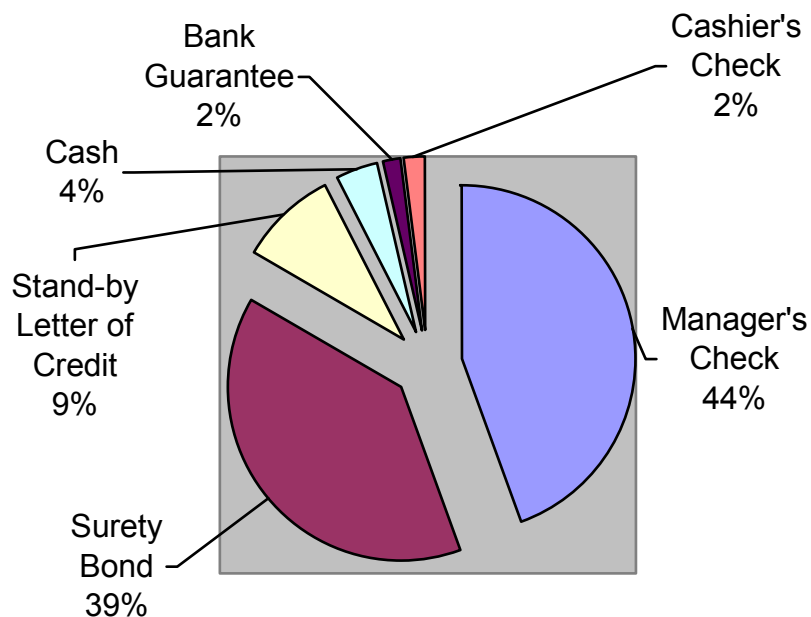
|                              |                             |
|------------------------------|-----------------------------|
| <input type="checkbox"/> Yes | <input type="checkbox"/> No |
|------------------------------|-----------------------------|
8. Do you think Bid Securities should be removed?  

|                              |                             |
|------------------------------|-----------------------------|
| <input type="checkbox"/> Yes | <input type="checkbox"/> No |
|------------------------------|-----------------------------|
9. If Bid Securities were to be removed, what alternative would you suggest?

Among one hundred (100) companies contacted, **fifty-two (52)** replied to the survey over the telephone, while **two (2)** submitted their responses through facsimile – bringing to **fifty-four (54)** the total number of respondents.

Following are the results of the suppliers' survey:

**A. Percentage of Bid Securities Most Favored by Suppliers**

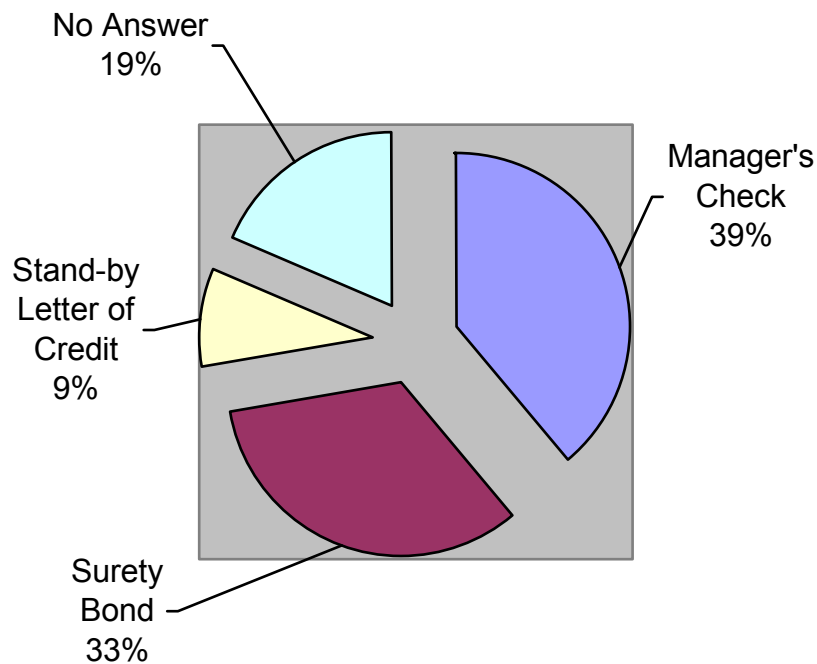


As indicated in the pie chart, **forty-four Percent (44%)** of the respondents considered Managers' Checks as the most favored Bid Security, while **thirty-nine percent (39%)** of the respondents opted for Surety Bonds. On the other hand, **nine percent (9%)** chose Stand-by Letters of Credit; **four percent (4%)**, Cash; **two percent (2%)**, Cashiers' Checks; and another **two percent (2%)**, Bank Guarantees.

Although a Manager's Check is considered by suppliers to be expensive by reason of the fact that actual funds equaling the amount of the check have to be maintained with the bank; it is the most favored bid security, because of the speedy process involved in its application and garnishment. In addition, most of the respondents have already established a good relationship with their banks, thereby making the process more convenient.

Surety Bonds were also preferred by many of the respondents because these involve less cost. However, most of the companies considered the application for a Surety Bond as a tediously long process, and one involving several documentary requirements. As for Cash, it was considered as one of the least favored bid securities, because it becomes a non-earning asset once furnished to the agency. That is the reason why most of the respondents opted for Managers' Checks instead, and considered it as more advantageous for companies. The difficulty in obtaining a Stand-by Letter of Credit was the primary reason why it received a particularly low rating among the respondents. Moreover, respondents claim that it was expensive to use, because banks ask for almost the full amount of the guarantee as collateral protection. Although Cashiers' Checks received the lowest rating, it is believed that this is primarily due to the fact that most respondents have equated it with Managers' Checks, because of the fact that these practically produce the same effects. As such, an answer that may have pertained to Cashiers' Checks would have evidently been given to Managers' Checks, the latter being the more common instrument in government contracts.

**B. Percentage of Performance Securities Most Favored by Suppliers**



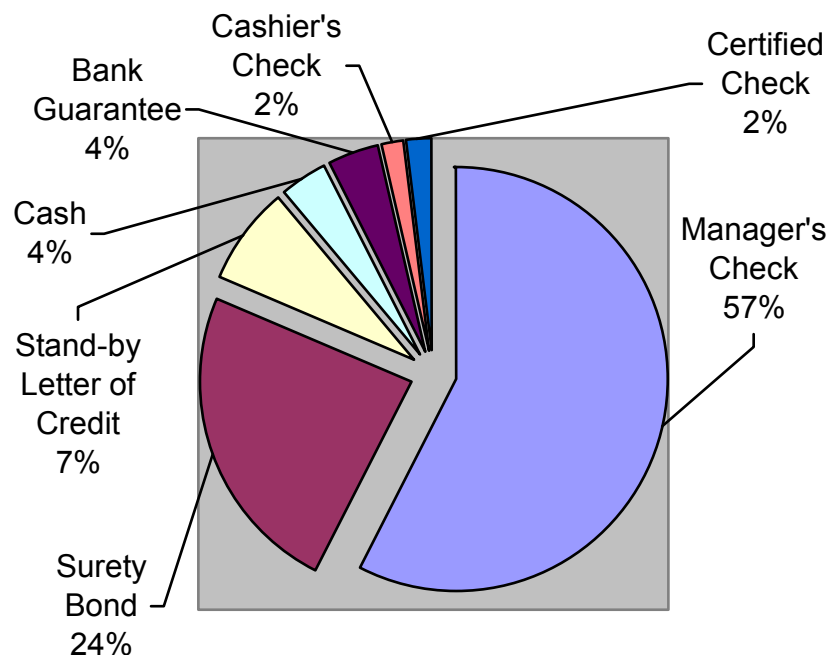
As viewed in the pie chart, **thirty-nine percent (39%)** of the respondents considered Managers' Checks as the most favored performance security, with **thirty-three percent (33%)** choosing Surety Bonds. As for the rest, **nine percent (9%)** of the respondents opted for Stand-by Letters of Credit, while **nineteen percent (19%)** gave no answers.

For most companies, the fact that a Manager's Check is faster to obtain than other types of securities makes it the most favored performance security. Furthermore, an established relationship with the bank makes the process simpler. In addition, most companies find Managers' Checks safe to use because they are less risky to carry, as compared to cash, and are considered as effective and as good as cash.

Once again, Stand-by Letters of Credit received a particularly low rating among the respondents. Similar to bid securities, the difficulty and the high cost involved in obtaining Stand-by Letters of Credit bear heavily against it.

The result is thus similar to bid securities.

**C. Percentage of Securities Easiest to Apply For**

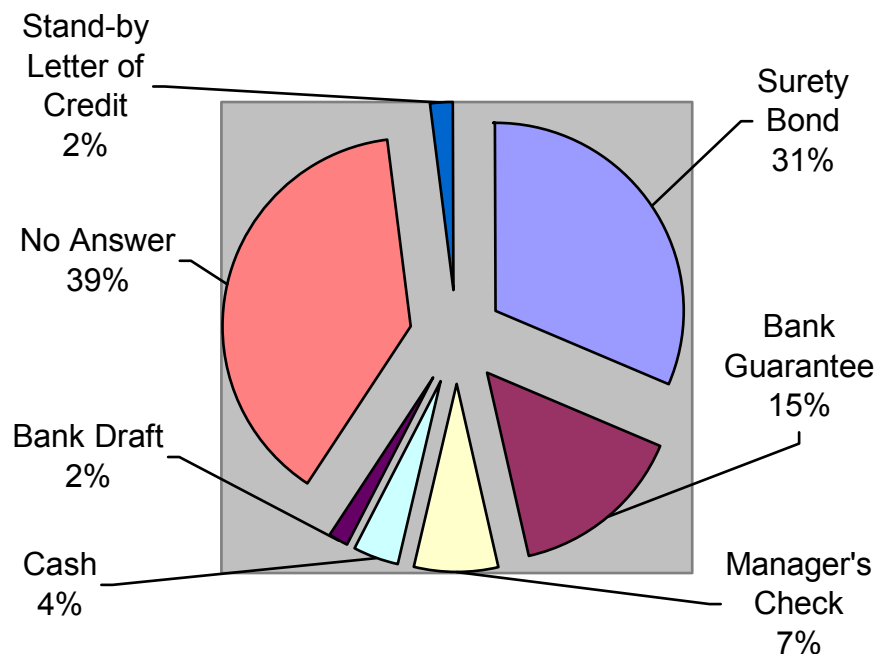


As indicated in the pie chart, **fifty-seven percent (57%)** of the respondents find Managers' Checks as the type of security easiest to apply for. Surety Bonds closely follow it, with **twenty-four percent (24%)**. **Seven percent (7%)** of the respondents opted for Stand-by Letters of Credit; **four percent (4%)** for Cash; **four percent (4%)** for Bank Guarantees; **two percent (2%)** for Cashiers Checks; and another **two percent (2%)** for Certified Checks.

Many companies prefer to use Manager's Check because, based on experience, these are more convenient and accessible. This bolsters the views expressed above by the same respondents with respect to why Managers' Checks are regarded as the most favored type of bid and performance securities. According to the respondents, as long as one has established a good relationship with his bank, and has proven to be a valued client, then there would be no problem in processing a Manager's Check. Of course, this has to be supported by a deposit of sufficient funds in the same bank.

Similar to the observation on Bid Securities above, although Cashiers' Checks and Certified Checks received the lowest ratings, it is believed that this is primarily due to the fact that most respondents have equated these with Managers' Checks, because of the fact that these practically produce the same effects. As such, an answer that may have pertained to Cashiers' Checks or Certified Checks would have evidently been given to Managers' Checks, the latter being the more common instrument in government contracts.

**D. Percentage of Securities Hardest to Apply For**

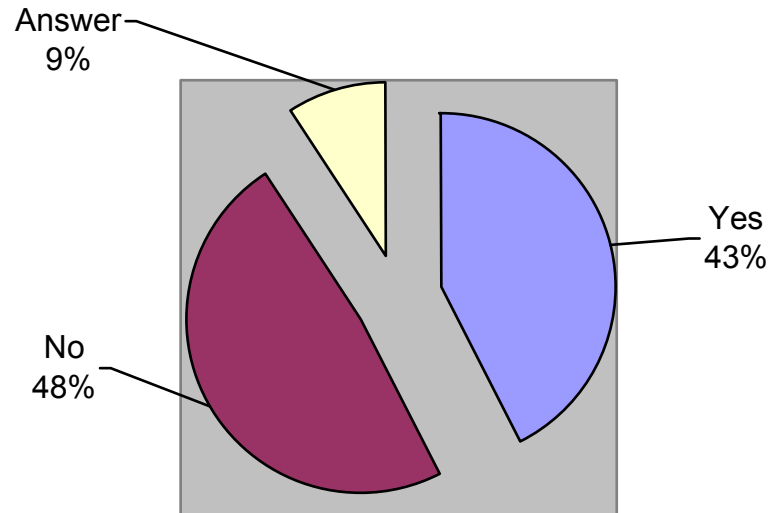


Based on the pie chart above, it could be seen that **thirty-nine percent (39%)** of the respondents opted not to give their answers to the question. On the other hand, **thirty-one percent (31%)** of the respondents chose Surety Bonds as the type of security hardest to apply for. For the others, **seven percent (7%)** chose Managers' Checks; **fifteen percent (15%)** chose Bank Guarantees; **four percent (4%)** chose Cash; and the remaining **two percent (2%)** of the respondents considered Bank Drafts as the type of security hardest to apply for.

Several respondents preferred not to answer the question because, according to them, they are usually consistent with the type of security they use. Consequently, most of these suppliers utilize only one (1) or two (2) types of securities. Due to familiarity and consistent use, suppliers find no problems in applying for their preferred types of securities. As such, in the absence of any point of comparison, these respondents had no way of determining which type of security is more difficult to apply for.

Consistent with the preceding survey results, a large number of respondents also claimed that Surety Bonds are difficult to apply for. According to them, the hassles of waiting up in queues and submitting a number of signed documents make the process of application very tedious and long. Once again, this supports the views of the same respondents above on why Surety Bonds are regarded as one of the securities highly disfavored among suppliers.

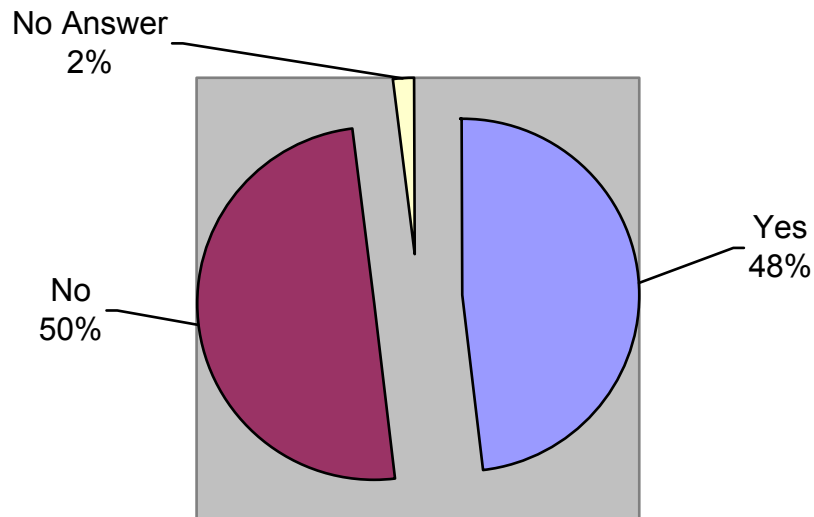
**E. Percentage of Suppliers in Favor of Stand-by Letters of Credit**



As shown in the pie chart, **forty-eight percent (48%)** of the respondents were not in favor of Stand-by Letters of Credit. On the other hand, **forty-three Percent (43%)** of the respondents said they favored Stand-by Letters of Credit. **Nine Percent (9%)** gave no answer.

According to those who were not in favor of Stand-by Letters of Credit, it is difficult to obtain this type of security because it is too expensive, considering the required collateral. Others even claimed that they have not been able to successfully apply for one, even after several tries. As for those who were in favor of Stand-by Letters of Credit, they see them as one of the safest types of securities.

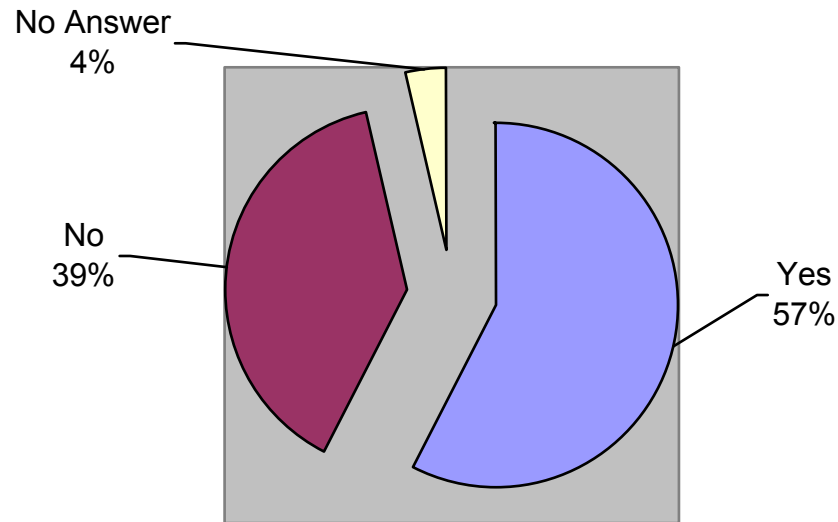
**F. Percentage of Suppliers in Favor of Bank Guarantees**



As indicated in the above pie chart, **fifty percent (50%)** of the respondents were not in favor of Bank Guarantees. On the other hand, **forty-eight percent (48%)** were in favor of this type of security. The remaining **two percent (2%)** of the respondents did not give any answer.

Due to the collateral required by banks, most suppliers find it difficult to apply for a bank guarantee. Additionally, the time it takes to apply for a Bank Guarantee makes suppliers opt for a different type of security instead. The respondents obviously preferred securities that are easily accessible.

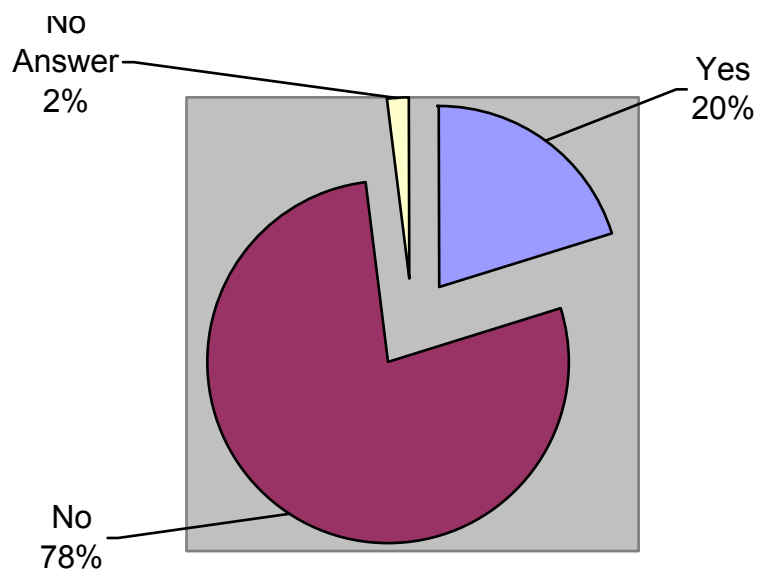
**G. Percentage of Suppliers in Favor of Surety Bonds**



Based on the above pie chart, it could easily be perceived that, among the three (3) types of bid and performance securities covered by this Study – Stand-by Letters of Credit, Bank Guarantees and Surety Bonds – Surety Bonds is the only one that is favored by majority of suppliers, with **fifty-seven percent (57%)** of the respondents answering in the affirmative. **Thirty-nine percent (39%)** of the respondents said that they did not favor Surety Bonds, while the remaining **four percent (4%)** did not give any answer.

Although suppliers complain about the hassles of applying for a Surety Bond and the amount of time it takes to process one, majority of them still favor it, because they believe that these are safe to use. Moreover, because of constant usage, some suppliers have gotten accustomed to the application process involved in obtaining a Surety Bond, eventually making these simpler to use.

**H. Percentage of Suppliers in Favor of Removing Bid Securities**



Interestingly, the pie chart above indicates that **seventy-eight percent (78%)** of the respondents were not in favor of removing bid securities, and only **twenty percent (20%)** expressed otherwise. **Two percent (2%)** of the respondents did not give any answer.

While most suppliers complained about the problems they encountered with respect to the requirement of a bid security, they still believe that it would be better to retain it. The respondents said that they understand the purpose and significance of bid securities, stressing that these are utilized to protect the government from fraudulent and anomalous bidders. The respondents further believe that the better measure to undertake is to address the problems that are usually encountered during the application process, rather than to remove bid securities altogether, as these are considered fundamental to the bidding process and serve as assurance to the government that bidders would indeed enter into contract with it if awarded the same.

As for those who stated that bid securities should be removed, some of them proposed the following alternatives:

1. Blacklisting;
2. Promissory notes;
3. Direct Selling;
4. Personal/Company check; and
5. Accreditation as an eligible supplier.

#### **IV. SURVEY OF CONTRACTORS**

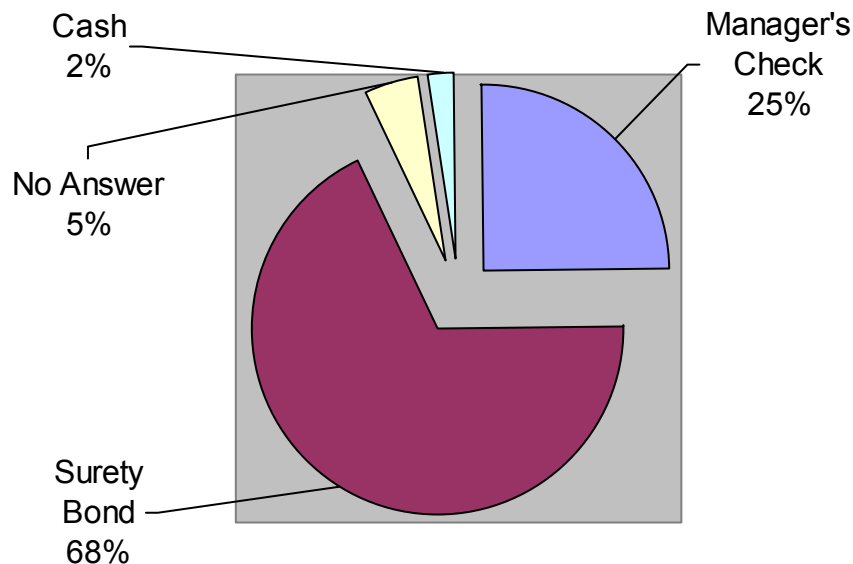
This Section gathers the views, experiences, preferences and sentiments of contractors dealing with the government through a survey that covers the basic issues and concerns of this Study with respect to the field of civil works. Survey forms containing the same questions as those presented to the suppliers in the immediately preceding section were either distributed through facsimile or answered through telephone inquiries. As with the suppliers' survey, the respondents were randomly chosen from the list of contractors registered with the CIAP.

Among one hundred (100) companies contacted, **forty-two (42)** replied to the survey over the telephone, while **two (2)** submitted their responses through facsimile – bringing to **forty-four (44)** the total number of respondents.

More specifically, out of the forty-four (44) respondents, **twenty-one (21)** were classified as large contractors, with an allowable range of contract cost of up to Fifty Million Pesos (Php50 Million) and beyond; **twelve (12)** were classified as medium contractors, with an allowable range of contract cost of up to Thirty Million Pesos (Php30 Million); and **eleven (11)** were classified as small contractors, with an allowable range of contract cost of up to Three Million Pesos (Php3 Million). For purposes of this Study, no distinction was made between sub-classifications of contractors within a particular category.

Following are the results of the contractors' survey:

**A. Percentage of Bid Securities Most Favored by Contractors**

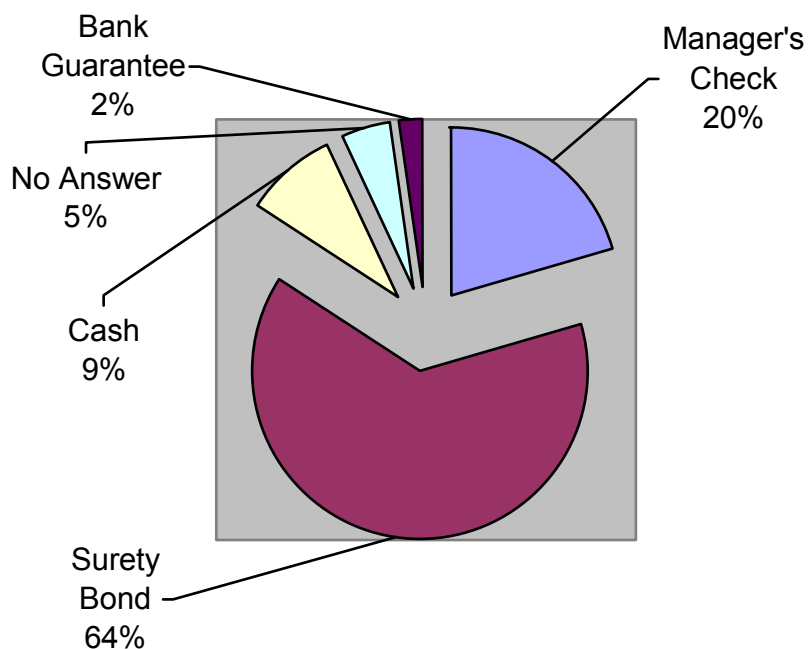


As seen in the pie chart, **sixty-eight percent (68%)** of the respondents considered Surety Bonds as the most favored Bid Security. Majority of the respondents from the small, medium, and large categories agreed that a Surety Bond was the most favorable type of bid security. On the other hand, **twenty-five percent (25%)** of the respondents opted for Managers' Checks; **two percent (2%)** chose Cash; while the remaining **five percent (5%)** of the respondents gave no answer.

Surety Bonds were the most favored Bid Security primarily because of the fact that these are less expensive to use. Although majority of the respondents complained about the tedious application process for a Surety Bond, as well as numerous documents and paperwork required, it is still preferred, because of the fact that these contractors are only required to pay for the premium makes it more advantageous for them. Interestingly, most of those who raised concerns about Surety Bonds were small contractors. According to them, since they are the ones who have least resources, it is difficult for them to secure all the documents required for their application, unlike large contractors who could readily secure such documents.

As for those who opted for Managers' Checks, the primary reason given was accessibility. Moreover, they prefer to use this, because a Manager's Check is considered as good as cash, but is still less risky to carry as compared to cash. Additionally, most of those who opted for Managers' Checks were medium and large contractors, and majority of these respondents claimed that they were valued clients of their respective banks, thereby making it easier for them to obtain such instrument.

**B. Percentage of Performance Securities Most Favored by Contractors**



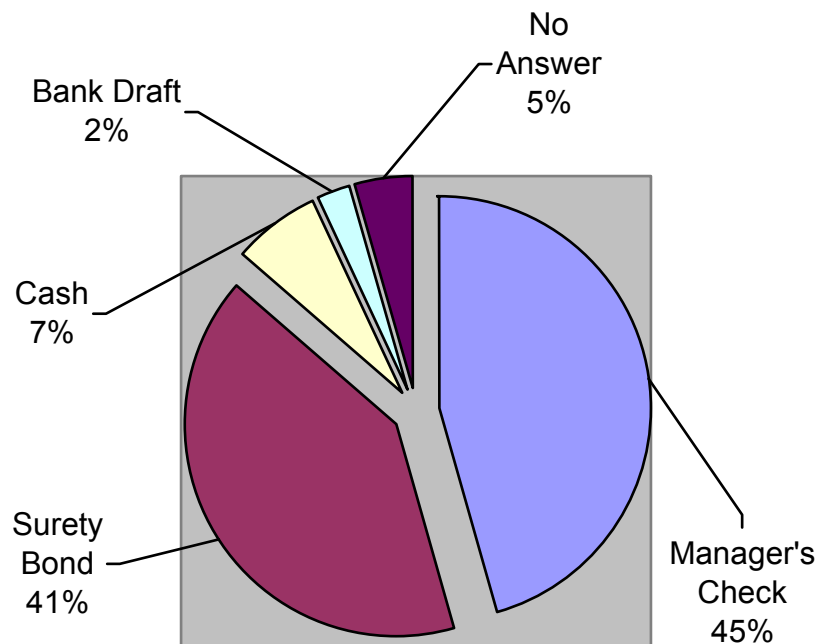
As indicated in the pie chart, **sixty-four percent (64%)** of the respondents considered Surety Bonds as the most favored performance security, while **twenty percent (20%)** chose Managers' Checks. As for the rest, **nine percent (9%)** of the respondents opted for Cash; **two percent (2%)** for Bank Guarantee; while **five percent (5%)** gave no answer.

Once again, Surety Bonds were considered to be the most favored performance security by most contractors, whether they were small, medium, or large. Aside from the fact that Surety Bonds were less expensive to obtain, the respondents also claimed that it is typically required by government agencies; therefore making it the most commonly used type of security. Furthermore, for the reason that only the premium is required to be paid, the cash position needed for the implementation of a particular project will not largely be affected. Bank Guarantees were considered by most contractors from all categories as least favored, because they claim that these were expensive to use, given the fact that the banks ask for almost the full amount of the obligation guaranteed as collateral protection.

Cash also received a low rating – mostly by large contractors – because, once furnished to an agency, it becomes a non-earning asset. Especially for large contractors, since most of their contracts amount to millions of pesos, this would result to a bigger cash outlay on their part, making Cash as performance security more disadvantageous in the long run.

The result is thus similar to bid securities.

**C. Percentage of Securities Easiest to Apply For**

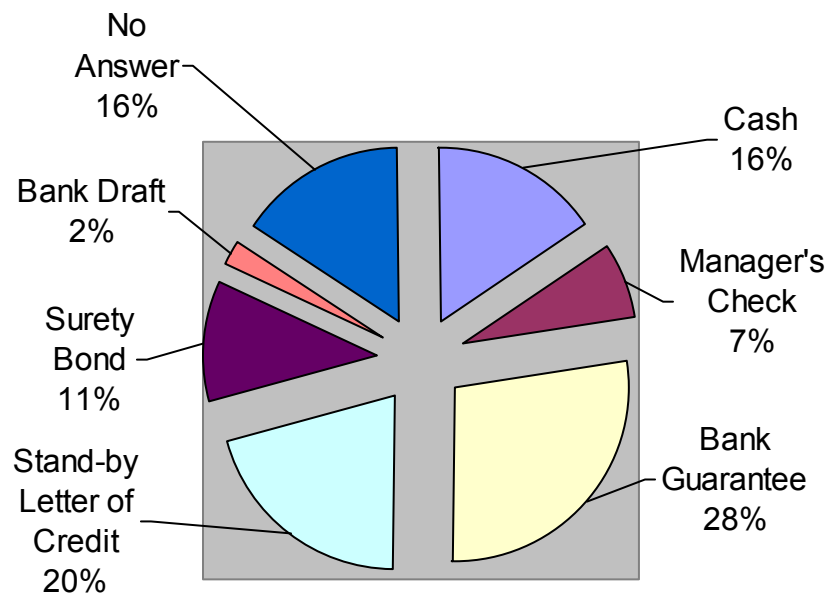


As shown in the pie chart, **forty-five percent (45%)** of the respondents considered Managers' Checks as the type of security easiest to apply for. This was followed closely by Surety Bonds with **forty-one percent (41%)**. **Seven percent (7%)** of the respondents opted for Cash; **two percent (2%)** for Bank Draft; while **five percent (5%)** did not give their respective answers.

When it comes to the application process, most of the contractors still believe that a Manager's Check is the most convenient. Most of the respondents who opted for this type of security were medium and large contractors. This is because, according to them, as long as one has proven to be a valued client of a bank, the Manager's Check could immediately be issued; provided that there are sufficient funds to support it.

For Surety Bonds, on the other hand, the lower cost involved in applying for one could be considered as the reason why several respondents considered this as easy to apply for as well – especially for small contractors. Nevertheless, several contractors still regard the process itself as arduous.

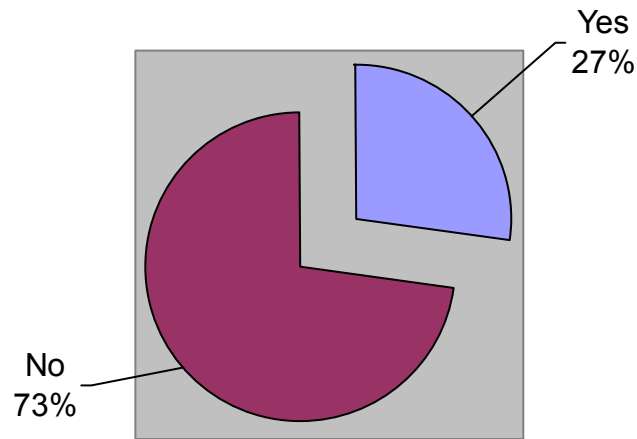
**D. Percentage of Securities Hardest to Apply For**



From the pie chart above, it could be seen that **twenty-eight percent (28%)** of the respondents considered Bank Guarantees as the type of security hardest to apply for. Following it were Stand-by Letters of Credit with **twenty percent (20%)**. **Sixteen percent (16%)** of the respondents chose Cash; **seven percent (7%)** chose Managers' Checks; **eleven percent (11%)** chose Surety Bonds; **two percent (2%)** chose Bank Drafts; while the remaining **sixteen percent (16%)** gave no answer.

A large number of respondents from the small, medium and large categories, claimed that Bank Guarantees are difficult to apply for, because of the expense involved. As previously stated, banks require for almost the full amount of the guaranteed obligation as collateral protection. Consequently, this reinforces the views of the same respondents who claimed that Bank Guarantees are their least favored type of bid and performance securities.

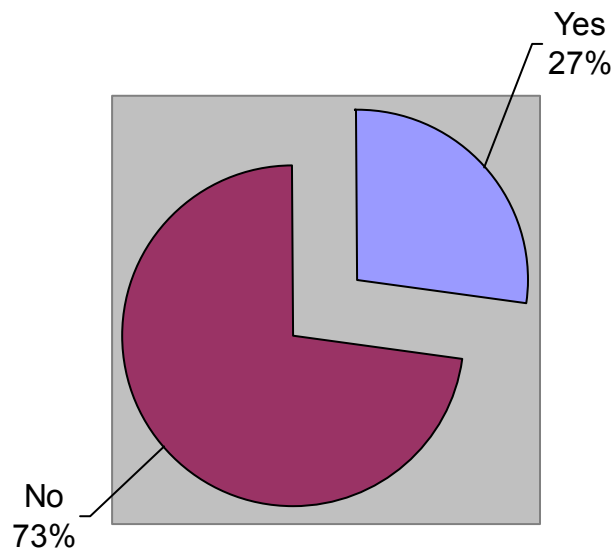
**E. Percentage of Contractors in Favor of Stand-by Letters of Credit**



As indicated in the pie chart, **seventy-three percent (73%)** of the respondents were not in favor of Stand-by Letters of Credit; while **twenty-seven percent (27%)** of the said they favored Stand-by Letters of Credit.

Stand-by Letters of Credit were viewed by majority to be expensive and difficult to apply for. Naturally, since accessibility is one of the major factors considered by contractors in choosing securities, Stand-by Letters of Credit do not count among those that are preferred.

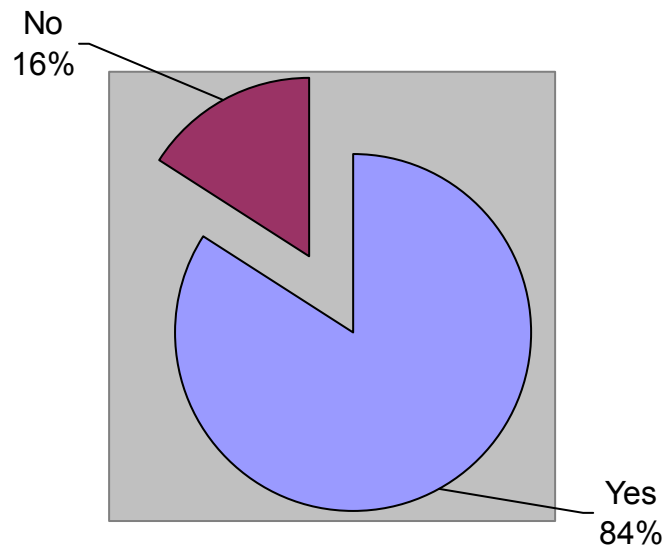
**F. Percentage of Contractors in Favor of Bank Guarantees**



Based on the pie chart above, **seventy-three percent (73%)** of the respondents were not in favor of Bank Guarantees; while **twenty-seven percent (27%)** were in favor of this type of security.

In view of the heavy collateral required by banks, majority of the contractors interviewed were not in favor of Bank Guarantees. Moreover, according to them, it also takes time before their application is approved by a bank. Once again, this only shows that most contractors – whether they are small, medium or large – prefer not to utilize this type of security.

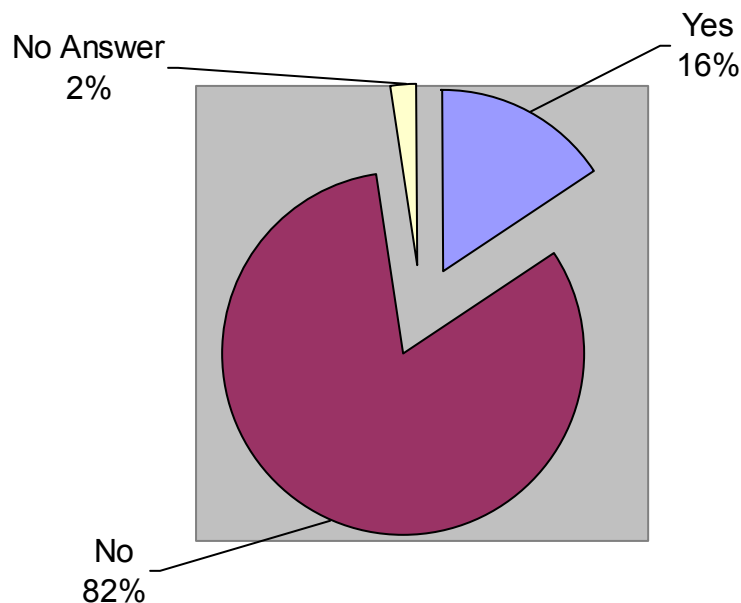
**G. Percentage of Contractors in Favor of Surety Bonds**



Consistent with the results of the suppliers' survey, it could still be seen that among the three (3) types of bid and performance securities covered by this Study, Surety Bonds remain to be the only one that is favored by majority of the respondents. Particularly, **eighty-four percent (84%)** of the contractors surveyed answered in the affirmative, while only **sixteen percent (16%)** said that they did not favor this type of security.

Due to the fact that contractors constantly utilize Surety Bonds, most of them have become more familiar with this type of instrument, thereby making it more comfortable to use. Notwithstanding the long application process for this type of security, as well as the numerous documents required, majority of the contractors from all categories still prefer to use Surety Bonds.

**H. Percentage of Contractors in Favor of Removing Bid Securities**



Apparently, the pie chart above indicates that **eighty-two percent (82%)** of the respondents were not in favor of removing bid securities, and only **sixteen percent (16%)** expressed otherwise. **Two percent (2%)** of the respondents did not give any answer.

Similar to the suppliers' survey, majority the contractors were not in favor of removing bid securities. As previously pointed out, the said respondents claimed that they understand the purpose served by this type of requirement. For them, a bid security is fundamental in the bidding process because it primarily serves as an assurance to the government that a bidder would indeed enter into a contract with it if awarded the same. Moreover, similar to the views of suppliers, the contractors surveyed alleged that the more appropriate measure to undertake is to address the problems that are usually encountered during the application process, rather than to remove bid securities altogether.

On the other hand, those who believed that bid securities should be removed were mostly large contractors, and some of them proposed the following alternatives:

1. Blacklisting;
2. Accreditation based on accomplishment; and
3. Promissory Notes.

**V. SUMMARY OF FINDINGS AND RECOMMENDATIONS**

**A. Summary of Findings**

The legal framework review of bid and performance securities, particularly letters of credit, bank guarantees and surety bonds, vis-à-vis the local business and practical experiences of the various parties involved in these instruments, has basically confirmed the obvious – that the procedures and requirements involved in applying for, issuing and garnishing these securities appear to be norms that have evolved from the very nature of these instruments. For example, it was shown that if any major reform were to be recommended to change the claim requirements for surety bonds, one would have not merely have to contend with established business customs, but also with fundamental principles that find their roots in the very nature of suretyship contracts, e.g., that of solidary obligations.

The proper approach to take would therefore be to ascertain the objectives that are practical and attainable and thus proceed accordingly, rather than to strive for goals that may sound more ideal than realistic, such as those having to do with the modification of well-entrenched legal principles. For this reason, the Study presented a practical approach to the subject matter by gathering the views of all the parties involved in a security instrument, namely the obligor, the issuer and the obligee. By looking at the environment and the disposition of the key players, it is able to present recommendations based both upon substance and consensus.

What the Agencies Say

Based upon the interviews conducted with the subject agencies, the following practices were discovered:

| <b>DOH</b>  | <b>DepEd</b>                                      | <b>DPWH</b>  |
|---|---|--|
| 1. Does not allow the submission of surety bonds. | 1. Does not allow the submission of surety bonds. | 1. Allows contractors to submit surety bonds as bid and performance securities, except for some foreign-assisted projects, because, except for JBIC, IFIs generally do not allow the submission of surety bonds. However, the removal of surety bonds is favored, because there are other forms of security that provide greater protection.<br><br>The requirement of a surety bond is not limited to those issued by the |

**A Study on Procurement Security and Guarantee Instruments**

Recommendations

|  |  | GSIS.   |
|--|--|---|
| <p>2. For locally funded projects, suppliers tend to prefer managers' checks and bank guaranties as bid and performance securities.</p> <p>For foreign-assisted projects, bank guaranties and letters of credit are more common.</p> | <p>2. For both local and foreign-assisted projects, suppliers tend to prefer managers' checks and bank guaranties as bid and performance securities.</p> <p>Additionally, for foreign-assisted projects, a few suppliers submit letters of credit.</p> | <p>2. For locally funded projects, contractors tend to favor surety bonds as bid and performance securities.</p> <p>Except for JBIC, IFIs generally do not allow the submission of surety bonds and only allow bank guaranties and letters of credit, thereby practically eliminating contractors' preferences.</p> |
| <p>3. Allows the submission of cash as bid and performance securities.</p>   | <p>3. Does not allow the submission of cash for both bid or performance securities.</p>  | <p>3. Allows the submission of cash as bid and performance securities.</p>  |
| <p>4. Cash and other securities equivalent to cash are deposited with the National Treasury.</p>   | <p>4. Securities equivalent to cash are, in most instances, held by the BAC Secretariat, subject to the issuance of a receipt.</p>   | <p>4. Cash and other securities equivalent to cash are deposited with the National Treasury.</p>  |
| <p>5. Reported no problems in 2002 and 2003 with respect to the garnishment of securities.</p>   | <p>5. No problems reported, because there were no reported claims filed against securities, nor any call made upon a security, in 2002 and 2003.</p>   | <p>5. Reported no problems in 2002 and 2003 with respect to the garnishment of securities, because it alleged a high success rate of recovery.</p>  |
| <p>6. Does not favor removing bid securities.</p>  | <p>6. Does not favor removing bid securities.</p>  | <p>6. Does not favor removing bid securities.</p>   |

These findings basically show the reservations that agencies heavily involved in goods procurement have over the effectiveness of surety bonds, as against the disposition of agencies involved in infrastructure. However, this dichotomy of predilection appears not to be one borne out of preference, but rather one based upon practicality; as it, in turn, merely reflects the preferred instruments of the suppliers and contractors reported by these agencies. True enough, while DPWH retains surety bonds as an allowable form of security, it has expressed its preference of removing the same in favor of other types of securities that offer more protection to the government.

Related to the above, another interesting finding was that none of the agencies reported any case in 2002 and 2003 whereby difficulties were experienced in the garnishment of securities. There are, however, reasons for this. As most complaints in the past pertained to surety bonds claims, the DOH and DepEd have removed the possibility of any such eventuality by opting not to allow the use of surety bonds. Particularly, in the case of the DOH, the case of the procurement of Ferrous Sulfate

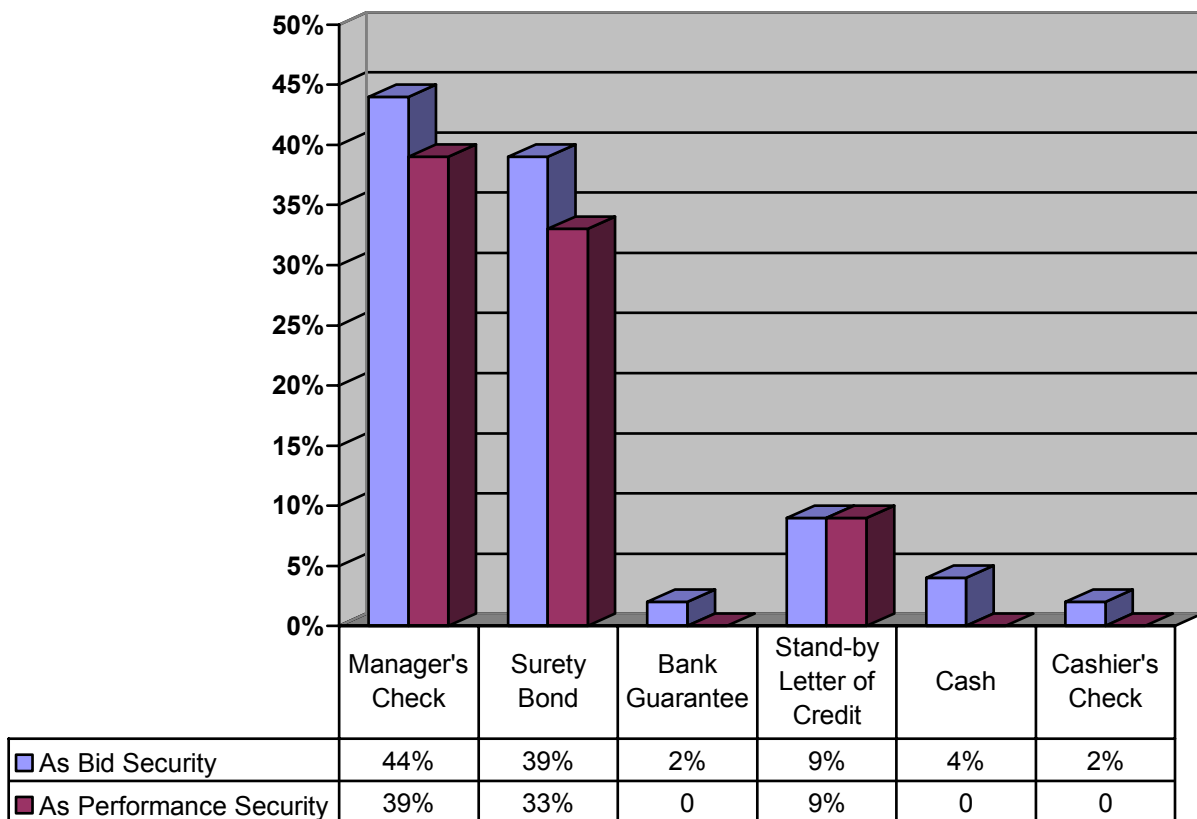
tablets in 1997 was a major influence in arriving at a decision not to allow surety bonds as early as 2001. Similarly, in the case of the DepEd, by not allowing bidders to post surety bonds, it has practically saved itself from having to deal with the same problems previously faced by the DOH. With respect to the DPWH, the decision to remove surety bonds is one that cannot be made without any proper consideration having been made because, as pointed out earlier and as may be seen below, the practicality of surety bonds for contractors of civil works projects is one that cannot be underestimated. At any rate, the DPWH has reported that, although it has experienced difficulty in garnishing surety bonds due to the necessity of filing suits in several instances, it has had a high success rate so far. While this claim is based primarily upon the accounts of the agency's own Legal Officer, this may be matched with the results of the interviews made with GSIS and the Malayan Insurance Company, Inc., which have reported a zero to less than one percent (1%) rate of claims filed against the total number of bonds – inclusive of surety bonds – issued in the past two (2) calendar years. Matched further with the results of the contractors' survey, which shows sixty-four percent (64%) favoring surety bonds and only eleven percent (11%) saying that it is the hardest security to apply for, it appears that both the government and the private sector appear to agree on the advantages of having surety bonds for civil works projects. This, therefore, brings to light the issue of whether or not it would be practical to remove surety bonds for civil works projects, a matter that was initially indicated above, but one that would be the subject of a deeper discussion subsequently.

Before moving unto the specific recommendations of the Study, it would help to summarize the results of the suppliers' and contractors' surveys.

What the Suppliers Say

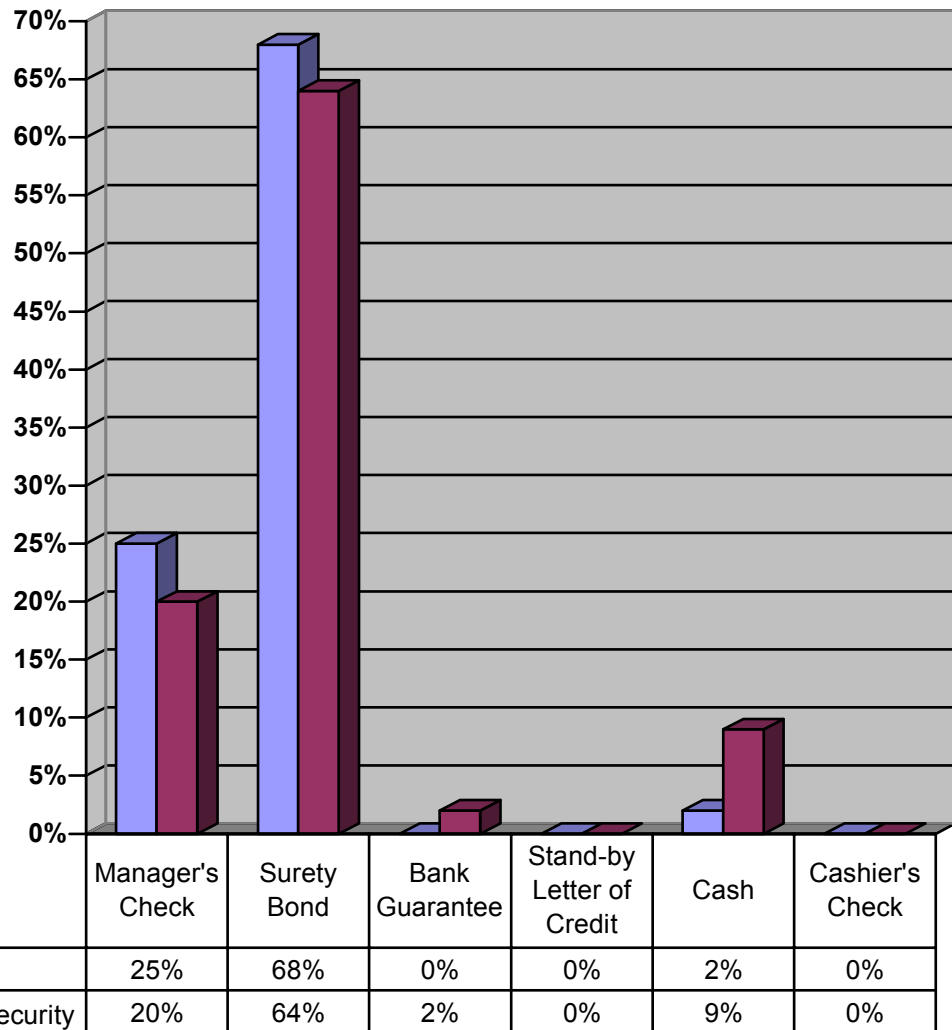
Based upon the suppliers' survey summarized in the graph below, while a surety bond ranks high as the favored form for bid and performance securities, it comes second only to a manager's check. The other types of securities did not receive encouraging marks. Although a manager's check is considered as an expensive form of security, as compared to surety bonds, due to the fact that a supplier would have to maintain actual funds in a bank to match the amount of the check during the life of the security, the proponent believes that there are two (2) causes why it ranks higher than surety bonds with respect to goods:

1. First of all, a contract for the supply of goods has relatively short time frame, as compared to most infrastructure projects, which means that issuing a manager's check is not as burdensome because a supplier is not required to commit the full amount of the security for long period. This, coupled with the relatively simple process involved in applying for a manager's check, makes it very attractive to suppliers.
2. Those considered for the survey were identified from the list of suppliers registered with the Government Electronic Procurement System. This means that the respondents were chosen from a population of suppliers who have not only been doing business with the government for a sufficient period of time, but who have also met the necessary criteria set by the government for legal, technical and financial capability – an indication that legitimate suppliers are generally able to back-up a security with sufficient funds.



What the Contractors Say

On the part of the contractors, a manager’s check ranks a far second from a surety bond as the most favored form for bid and performance securities – garnering only a percentage of twenty-five (25) and twenty (20), respectively, as against the corresponding sixty-eight percent (68%) and sixty-four percent (64%) received by surety bonds. Although the application procedure and requirements for surety bonds are considered tedious as compared to those for managers’ checks, contractors have gotten used to the former because it is less expensive to use and less cumbersome in the long run, especially considering that once a bidder wins a contract, the same form of bid security would normally be adopted as its performance security. However, still on the issue of financial capability, it is worth noting that majority of those who favored managers’ checks over surety bonds were the medium and large contractors.



### Analysis on the Effectiveness of Securities

Based upon the above results, it is thus clear that government agencies and suppliers/contractors have differing views on bid and performance securities, and that these views are inevitably intertwined with their diverse experiences from each side of the fence. In particular, while suppliers and contractors are more concerned about the facility of applying for securities that involve the least cost; government agencies are focused on securities that offer the widest coverage and the highest certainty in case of claim. For this reason, an analysis on the effectiveness of securities would have to consider the concerns of both parties to a government contract, *i.e.* that a particular security would have to be both accessible to suppliers/contractors and provide sufficient cover to agencies.

In view of the foregoing, a look into standby letters of credit, bank guarantees and surety bonds would bring forth the following results:

As to standby letters of credit and bank guarantees, the subject agencies have themselves vouched for the effectiveness of these securities, and this is confirmed by the interviews conducted with banking institutions, because it was affirmed by the latter that payment of claims are based merely upon the presentation of documents and not upon actual existence or non-existence of facts. As such, these instruments may be considered very effective in guaranteeing the performance of public contracts. However, it must be considered that, in order to provide this sort of facility to agencies, banks would naturally have to protect themselves against claims. This protection comes in the form of the credit line and the fifty percent (50%) to eighty percent (80%) collateral requirements that would have to be shouldered by the bidders, suppliers or contractors.

Given the effectiveness of standby letters of credit and bank guarantees, it would do well to encourage suppliers and contractors to adopt these forms of securities in their transactions with the government. But, as seen from the suppliers' and contractors' surveys, these securities are regarded as highly disfavored. Considering that the reason for this low ranking is the fact that these instruments require heavy collateral protection and are thus expensive to use, increasing the marketability of these securities would naturally require an initiative to lower the collateral requirements of banks. See Subsection H below for further discussion on this subject.

With respect to surety bonds, the subject agencies have clearly expressed their judgment as to the ineffectiveness of these types of securities, as far as the government is concerned. Once again, this is confirmed by the interviews conducted with insurance companies, because it was shown that approval of claims go through the entire procedure of pre-processing, endorsement, and then final processing and determination with their respective Claims Departments. This procedure is undertaken to verify if there are any valid defenses that the surety or insurance company can raise against the claimant – whether inherent in the obligation itself, personal to it, or personal to the principal obligor – so that in case such a defense exists, the same may be sufficient grounds for the surety or insurance company to raise in court litigation. This is in contrast to the procedure outlined earlier for

garnishing standby letters of credit and bank guaranties, wherein the bank, not being a party to the original contract, only deals with documents; and whereby, in actual practice, some banks merely require the claimant agency to submit a notarized certification advising it of the default which need not even be confirmed by the defaulting party.

As mentioned earlier, the very fact that a surety is held primarily liable under the contract is sufficient incentive for it to demand more requirements from claimants and conduct a more critical review thereof, so much so that the surety or insurance company does not pay a claim immediately after it is made, because its Claims Department needs to look at both sides of the contract involved to determine whether the claim is indeed proper. Obviously, given the uncertainty of claims collection, surety and insurance companies have enough incentives and room to lower or even remove any collateral requirement for a surety bond, so as to increase its marketability with the suppliers and contractors. In turn, discounting the documentary requirements involved in an application, this makes surety bonds very favorable for the latter, but quite problematic for government agencies.

However, it has clearly been established earlier that any difficulty experienced by an agency in claiming against a surety bond may not necessarily be the result of malleable internal practices, policies, rules and procedures of any particular surety or insurance company, nor that of any locally established business custom, but rather one that finds its roots in the very nature of a suretyship contract brought forth by well-entrenched laws and jurisprudence. Therefore, any effort to address the ineffectiveness of surety bonds for agencies would necessarily have to delve into the practicality of maintaining these as securities for government projects, because the alternative which is to actually amend universal legal principles on suretyship may prove to be Herculean. See Subsection D below for further discussion on this subject.

***B. Retaining Bid Securities***

In line with the approach described above, this Study has clearly shown the prevailing sentiment on one major issue: that of whether or not bid securities should be removed from the public bidding requirements. Needless to say, the agencies interviewed were not in favor of such a proposal, because of the understandable sentiment that bid securities tend to screen out bidders who either participate in bad faith, or lack the capacity to actually participate in the project concerned. However, one would think that the sentiment on the side of suppliers and contractors would be opposite that of the agencies, because of the added burden that bid securities entail. Interestingly though, based upon the surveys conducted, it appears that any move to strike out bid securities as among the bidding requirements would not gain much support from both suppliers and contractors, with seventy-eight percent (78%) of suppliers and eighty-two percent (82%) of contractors saying that they did not favor removing this type of security. While most suppliers and contractors complained about the problems usually encountered with respect to bid securities, they still believe that it would be better to retain this type of requirement, as it is considered fundamental to the bidding process and serves as an assurance to the government that a bidder would indeed enter into a contract with it if awarded the same. These suppliers and contractors said that they appreciate the purpose and significance of a bid security, because it is utilized to protect the government from fraudulent and anomalous bidders. As such, the better measure to undertake is to address the problems that are usually encountered during the application process, rather than to remove bid securities altogether.

***C. Suggested Alternatives and Existing Reforms***

Part of the CPAR recommendations that falls within the ambit of the Study is the development of alternative means to make the security system flexible while ensuring that the objectives in imposing bid and performance securities are attained. For this reason, suppliers and contractors were asked to provide their suggestions, and below were the primary alternatives given:

1. Blacklisting;
2. Accreditation as eligible supplier or contractor, based on accomplishments; and
3. The use of promissory notes.

The last suggestion may appear to address problems associated with the application for bid and performance securities, but it does not necessarily address the concerns involved in calling upon or garnishing these securities. On one hand, the use of promissory notes would remove the need to put up substantial collateral or cash to back-up the issuance of a security, because it actually removes the issuer from the picture and limits the transaction between the obligor and the obligee, of course unless an accessory guarantee is attached to it which would in effect render the entire alternative useless as it would revert the entire transaction to that of the existing guarantee and surety instruments. However, on the other hand, the absence of any guarantor or surety would mean that the government agency would have to depend on the word of the supplier or contractor that it would pay the

amount covered by the promissory note in case of default. In an ideal world with more than ideal parties, this recommendation may seem sound; but in an actual contract setting where parties naturally tend to contest the existence of default events and the amount of damages, the advisability of using promissory notes immediately becomes questionable. Even in a simple scenario where one party seeks to call upon the other party to task, the tendency of the latter is to exhaust all possible means – legal or otherwise – to resist the claim. It is for this very reason that security instruments were conceived in the commercial and business world, such that a third party is involved and may be called to perform in order to avoid any direct conflict and litigation between the contracting parties. Truly, in the absence of any guarantor, the use of promissory notes would merely increase the incidence of suits. As such, while promissory notes may be advantageous for suppliers and contractors, it offers no security to the government that the obligor will perform without having to resort to judicial means.

With respect to the matters of blacklisting and accreditation, it should be noted that the GOP has either adopted measures to address these, or is in the process of developing such measures, through the following:

1. The strengthened provisions of R.A. 9184 on administrative sanctions;<sup>51</sup>
2. The enhanced role of the GPPB as the central policy body for the blacklisting of suppliers, contractors and consultants;<sup>52</sup>
3. The development of a centralized on-line list of blacklisted suppliers, contractors and consultants with the Government Electronic Procurement System; and
4. The detailed procedures and requirements for the eligibility check of suppliers, contractors and consultants, supported by a stringent postqualification process.<sup>53</sup>

In addition to the foregoing, the following existing GOP reforms are also intended to address issues of accountability and performance in government contracts and public bidding:

1. The provisions of R.A. 9184 on penal sanctions and civil liabilities;<sup>54</sup>
2. As pointed out in Section II.A of this Study, R.A. 9184 contains provisions on contract warranties, whereby:
  - a) For the procurement of goods, in order to assure that manufacturing defects shall be corrected by the supplier, manufacturer, or distributor, as the case may be, a warranty shall be required from the contract awardee for a minimum

<sup>51</sup> See R.A. 9184, IRR-A, Rule XXIII.

<sup>52</sup> R.A. 9184, IRR-A, Rule XXIII, Sec. 69.4.

<sup>53</sup> See R.A. 9184, Arts. VIII and X.

<sup>54</sup> See R.A. 9184, Arts. XXI and XXII.

period of three (3) months, in the case of supplies, and one (1) year, in the case of equipment, after performance of the contract; which warranty shall be covered by either retention money in an amount equivalent to at least ten percent (10%) of every progress payment, or a special bank guarantee equivalent to at least ten percent (10%) of the total contract price;<sup>55</sup> and

- b) For the procurement of infrastructure projects, after final acceptance of the project by the government, the contractor shall be held responsible for structural defects and/or failures of the completed project within the following warranty periods from final acceptance, except those occasioned by *force majeure* and those caused by other parties:<sup>56</sup>

Permanent Structures – Fifteen (15) years  
 Semi-Permanent Structures – Five (5) years  
 Other Structures – Two (2) years

The contractor shall be required to put up a warranty security in the following forms and in accordance with the following schedule:

| <b>Form of Warranty</b>                        | <b>Minimum Amount in % of Total Contract Price</b> |
|--|--|
| 1. Cash deposit, cash bond or letter of credit | Five percent (5%)                                  |
| 2. Bank guarantee                              | Ten percent (10%)                                  |
| 3. Surety bond                                 | Thirty percent (30%)                               |

- 3. As mentioned in Section II.A of this Study, R.A. 9184 no longer makes any specific reference to GSIS surety bonds, except in the case of the warranty provision on infrastructure projects, and even in the latter case, surety bonds from other insurance and surety companies are clearly allowed; and
- 4. As mentioned again in Section II.A of this Study, the various forms of securities are listed in R.A. 9184 in the alternative, thereby granting the procuring entity the right to choose which security would be more advantageous for the project, and also giving the bidder, supplier or contractor the right to choose which among the enumerated forms, or combination thereof, would be furnished to the procuring entity.

It is interesting to note at this point that, despite all the above measures, agencies, suppliers and contractors still agree that bid securities should be retained. At any rate, it is indubitable that the new procurement law of the Philippines provides sufficient protection to the government against defaulting suppliers and contractors. As such, the obvious recommendation at this point is for the GPPB to establish

<sup>55</sup> R.A. 9184, IRR-A, Rule XIX, Sec. 62.1.  
<sup>56</sup> R.A. 9184, IRR-A, Rule XIX, Sec. 62.2.

sufficient monitoring and assistance mechanisms to ensure that the reforms are being properly and effectively implemented in the field level by agencies.

#### ***D. Removal of Surety Bonds***

A glimpse at the results of the agency interviews and the surveys of suppliers and contractors would show one glaring message – while agencies disfavor surety bonds, suppliers and contractors believe otherwise, with fifty-seven percent (57%) of suppliers and eighty-four percent (84%) of contractors saying that they favor surety bonds. This does not necessarily mean, however, that an insurmountable conflict exists; for a closer look at the findings would show the following:

1. That agencies heavy into goods procurement have successfully scraped surety bonds from its list of bid and performance securities, a move that is clearly allowed by law despite the fact that surety bonds are still listed therein;
2. That while contractors heavily favor surety bonds because of its affordability, suppliers do not generally share as strong a sentiment, due to the factors discussed earlier;
3. That complaints have often been raised by suppliers and contractors alike regarding the heavy documentary and procedural requirements; and
4. Legitimate suppliers with government contracts that are generally above-board favor managers' checks as bid and performance securities more than surety bonds.

In view of the foregoing, the Study would definitely advise against the abrupt passage or issuance of any policy that would remove surety bonds as a form of bid or performance security, as this would not only meet stiff resistance from the private sector but would also cause some hardship and confusion to those who have become accustomed to this particular legal instrument. Nor would it be advisable to recommend a limitation upon the rights of surety bond issuers to defend against claims, because this would in fact imply having to lobby for a radical change in settled principles found in law and jurisprudence – particularly as far as the Philippine setting is concerned. Rather, this Study proposes a tiered approach, so that the removal of surety bonds may initially be undertaken for specific sectors or categories.

In particular, as suppliers have favored managers' checks over surety bonds, it appears that any initiative to remove surety bonds from the list of allowable bid and performance securities would not meet any strong objection from suppliers, despite the fact that surety bonds still rank as highly favored among them, as this may easily be replaced by managers' checks. The latter type of security has the advantage of offering easy and full satisfaction of claims to government agencies while, at the same time, providing suppliers with an instrument that is convenient and easy to apply for. The experience of the DOH with respect to the successful forfeiture of erring bidders' managers' checks as bid securities in its various procurement

activities further supports this view. The fact that agencies have already successfully implemented such an initiative in their individual capacity lends to the practicality of such a recommendation. Even the representative of the private commercial bank interviewed for this Study shares the view that a manager's check is preferred by both parties to a contract, because it is convenient for the obligor who has established a sound business relationship with his bank, as well as for the obligee who may easily forfeit the security in case of default by depositing the same in his own bank. Of course, this presumes a contract or obligation that is above board. It is recommended that the GPPB, through its TSO, develop a policy on this matter after conducting the necessary workshops and dialogues with agencies and the private sector. It may also initiate the process through a test phase for bid securities, so that once it is successful at this stage, it may then proceed to develop a more comprehensive program to cover performance securities as well. Any decision to remove surety bonds, or any form of bid or performance securities for that matter, would not be difficult to adopt, because the allowable forms are merely enumerated in IRR-A, in accordance with Sections 27 and 39 of R.A. 9184. This means that legislation is not necessary to pursue the recommendations provided herein.

With respect to civil works, individual infrastructure agencies may experiment with the removal of surety bonds on a case to case basis. As stated earlier, the law allows this to be done, because the list of bid and performance securities is provided alternatively. However, particular attention has to be given on the practice whereby surety and insurance companies would offer commissions to public officials who are able to refer bidders, suppliers or contractors to them in relation to procurement activities being undertaken by the procuring entity to which these public officials belong. Based on these personal accounts, the commissions offered can reach up to ten percent (10%) of the amount of the premium paid by the bidder, supplier or contractor. This commission may actually amount to a high figure if one were to consider that it is applicable not only to surety bonds issued as bid securities, but to all other types of bonds and insurance schemes that the surety or insurance company may end up issuing to a supplier or contractor during the course of the contract, in case he wins the same.

While some officials may see no issue in receiving commissions from surety and insurance companies, it has to be stressed that this clearly falls within the concept of a "corrupt practice," if one were to define it as:

A behavior on the part of officials in the public or private sectors by which they improperly and unlawfully enrich themselves and/or those close to them, or induce others to do so, by misusing the position in which they are placed, and it includes the offering, giving, receiving, or soliciting of anything of value to influence the action of any such official in the procurement process or in contract execution.<sup>57</sup>

It also appears that the practice of accepting commissions in exchange for referrals runs against the principle behind Section 1 of Act No. 536, as amended by Act No. 2206, which provides that whenever any bond conditioned for the faithful

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<sup>57</sup> See The Asian Development Bank, *Guidelines for Procurement under Asian Development Bank Loans* (February 1999); see also The World Bank, *Guidelines for Procurement under IBRD Loans and IDA Credits* (January 1999).

performance of any duty to or contract with any public authority is, by the laws of the Philippines or by the regulations of any public authority therein, required or permitted to be given with one or more sureties, no officer or person having the approval of any bond shall require that it shall be furnished by a guarantee company, or by any particular guarantee company.

Agencies should therefore have clear internal rules against this practice, particularly those engaged in infrastructure projects, and strict implementation should be enforced. A resolution from the GPPB clarifying the illicit nature of such a practice is essential.

### ***E. GSIS Surety Bonds***

While there seems to be no sufficient data within the last two (2) years to support a determination that GSIS surety bonds, as distinguished from those issued by private surety and insurance companies, are generally difficult to forfeit or garnish, an important concern was raised by the DOH – one which, at the least, deserves substantive policy review by the GOP – that of conflict of interest. In particular, it was alleged that a government agency should not accept GSIS surety bonds as a security in a public bidding or as a requirement to a contract, because:

1. In case of any dispute arising from a claim, a conflict of interest may arise out of the fact that both would eventually be represented by the Solicitor General's Office; and
2. In case of a successful claim upon a GSIS surety bond, for the reason that two (2) government agencies are involved, any recovery therefrom would merely entail the transfer of funds from one pocket to another pocket of the government.

Several public officers and individuals have concurred with these concerns, including representatives from the DPWH and PWI. However, any recommendation in this regard would have to be one focused on a policy review by the government, as it may involve the amendment of some laws, such as the charter of the GSIS. The views of the Solicitor General's office on the matter would be indispensable.

### ***F. Depositing Cash and Cash Equivalent Securities***

There are agencies, such as the DOH and the DPWH, that deposit cash securities and other instruments that are treated as cash, such as certified, cashiers' and managers' checks, with the National Treasury, because according to them they are required to do so by law. As such, these securities are forwarded to the cashier of the agency who, in turn, deposits them. The legal basis cited for the above practice is Section 44 of E.O. 262, which provides that:

[U]nless otherwise specifically provided by law, all income accruing to the departments, offices and agencies by virtue of the provisions of existing laws, orders and regulations shall be deposited in the National Treasury or in the duly authorized depository of the Government and shall accrue to the unappropriated surplus of the General Fund of the Government:

*Provided*, That amount received in trust and from the business-type activities of government may be separately recorded and be disbursed in accordance with such rules and regulations as may be determined by the Permanent Committee created under this Act.

A problem, however, arises when bidders, suppliers or contractors finally request for the return of these securities. As these securities have entered into the General Fund of the GOP, a request for a Notice of Cash Allocation (NCA) from the DBM is required under budget laws, such as P.D. 1177, before the same may be released to bidders, suppliers or contractors – a process that could take a considerable length of time, or approximately three (3) to four (4) months in the case of the DPWH. This length of time, in turn, results to higher prices, because the bidders, suppliers or contractors immediately input the expected cost of money for the expected period involved.

One view is that agencies need not deposit cash securities or equivalent instruments into the National Treasury, because these do not belong to the agency in the first place, so that until the agency forfeits these securities it does not have any right to claim these as its own, and until that time, the same cannot be considered as income to the agency. As such, it may be better practice to allow BACs to simply safe-keep these securities in a safety deposit box. However, there have been instances where cash securities that were kept in a box within the agency have managed to disappear, thereby requiring the BAC chairman to take responsibility for the incident. Moreover, some officials have raised the fear that there is currently no provision of law that allows them to adopt this practice.

Another view is to deposit these securities in a trust account. This alternative is in line with the law, because the last sentence of Section 44, Chapter 5, Book VI of E.O. No. 292 recognizes the same. In this regard, Section 45 of the same E.O. further provides as follows:

Receipts shall be recorded as income of Special, Fiduciary or Trust Funds or Funds other than the General Fund, only when authorized by law and following such rules and regulations as may be issued by a Permanent Committee consisting of the Secretary of Finance as Chairman, and the Secretary of Budget and the Chairman, Commission on Audit, as members. The same Committee shall likewise monitor and evaluate the activities and balances of all Funds of the national government other than the General Fund and may recommend for the consideration and approval of the President, the reversion of the General Fund of such amount as are (1) no longer necessary for the attainment of the purposes for which said Funds were established, (2) needed by the General Fund in times of emergency, or (3) violative of the rules and regulations adopted by the Committee: *Provided*, That the conditions originally agreed upon at the time the funds were received shall be observed in case of gifts or donations or other payments made by private parties for specific purposes.

The GAA – a yearly legislation – normally has more specific provisions on the matter in its General Provisions. For example, in Section 7 of the GAA for Fiscal Year 2003 provided as follows:

Performance Bonds and Deposits. Performance bonds and deposits filed or posted by private persons or entities with agencies of the government shall be deposited with the National Treasury as trust receipts under the name of the agency concerned. Upon faithful performance of the undertaking or termination of the obligation for which the bond or deposit was required, any amount due shall be returned to the filing party by the office or agency concerned, withdrawable in accordance with accounting and auditing rules and regulations: *Provided*, That any interest accruing on deposits and any forfeited amounts on performance bonds and deposits shall be deposited with the National Treasury and shall accrue to the General Fund pursuant to Section 44, Chapter 5, Book VI of E.O. No. 292.

Section 5 of the same GAA further provides as follows:

Trust Receipts. Receipts from non-tax sources authorized by law for specific purposes which are collected/received by a government office or agency acting as a trustee, agent or administrator, or which have been received as guaranty for the fulfillment of an obligation, and all other collections classified by law or regulations as trust receipts shall be booked as trust liability account of the agency concerned and deposited with the National Treasury.... Disbursement out of such funds shall be made in accordance with the purpose for which the fund is created and subject to accounting and auditing regulations.

It is thus very clear under the law that bid and performance securities, including cash and its equivalent, are deposited with the National Treasury, but as trust receipts. As such, the withdrawal of the amounts covered by these instruments would have to vary from those requiring the regular issuance of an NCA from the DBM, thereby saving a bidder, supplier or contractor from the agony of having to wait for the agency to undergo the tedious process involved thereby. However, it appears that the problem involves the fact that some officials are either not aware of this legal process, an effect of the lack of clear guidelines.

To be sure, an ideal recommendation may actually be to eliminate cash as a form of security altogether, but this does not solve the problem with respect to those instruments that are considered as cash equivalent, such as certified, cashiers' and managers' checks. Nor is such a proposal widely accepted, particularly by the DPWH, which believes that cash should not be removed as an allowable bid or performance security, because it is the easiest way for contractors to supplement securities.

In view of the foregoing, it is recommended that the government should issue clear guidelines on how bid and performance securities in general, including cash and equivalent instruments it, in particular, should be treated under acceptable public budget, accounting and auditing principles. These guidelines may include a provision that allows the safekeeping of these securities in a duly designated safety

deposit box, whether within the premises of the agency concerned or a duly nominated government financial institution. From the above-cited provisions, it appears that the proper agency to issue these guidelines would either be the DBM or the Permanent Committee created under Section 45, Chapter 5, Book VI of E.O. No. 292.

### ***G. Proper Monitoring of Securities***

One often hears the hackneyed truism that the problem may not necessarily lie in the policy but in its implementation. Unfortunately, this adage may hold true for some agencies when it comes to utilizing bid and performance securities. In particular, some project management offices may be too focused on the proper phasing and implementation of the project, but may forget to monitor an equally important aspect of the contract – that the securities intended to cover damages suffered on account of default are properly accounted for and are maintained valid and existing. Failure on this regard would mean a failure on the part of the agency to properly utilize these securities, as there have been actual instances when bidders, suppliers and contractors defaulted in their obligations, but have not been held accountable because their securities were simply permitted to expire, whether intentionally or by sheer oversight.

The GPPB may consider issuing a resolution on this matter in order to remind agencies of the importance of properly monitoring bid and performance securities.

### ***H. Standby LCs and Bank Guarantees with Waiver of Excussion***

A bank guarantee is one form of security that does not enjoy the acceptance of the majority of suppliers and contractors, with fifty percent (50%) of the former and seventy-three percent (73%) of the latter saying that they did not favor it. The primary reasons for this condition are the amount of collateral normally required by banks and the process involved before an application is finally approved. The same holds true with standby letters of credit. On the other hand, government agencies tend to favor bank guarantees because, coupled with the waiver by the bank of the benefit of excussion – the right of the guarantor to require the obligor to first exhaust all legal remedies against the obligee before seeking relief from the guarantor – agencies are afforded expeditious satisfaction of their claims. By virtue of the waiver of the benefit of excussion, a bank guarantee provides the same benefit to agency as a standby letter of credit – the assurance that the bank will pay upon mere submission by the claimant of complete documentary requirements.

As such, although requiring standby letters of credit and bank guarantees may appear as sound business practice to an agency, the submission of these types of securities would not necessarily amount to good practice for several suppliers and contractors. However, one has to understand that the nature of these types of securities cannot be modified to favor the latter, without concurrently and proportionately disfavoring the former. For example, one may suggest the removal of the collateral requirement attached to bank guarantees; but to protect itself, sound business judgment would motivate the bank to seek the benefit of excussion in case of claims filed against it, thereby allowing it to question the propriety of claims

submitted – a situation that would invariably affect the “callability” of this type of security, one that is similarly faced by agencies in the case of surety bonds.

In order to maintain the “callable” nature of standby letters of credit and bank guarantees while at the same time making these instruments easily available to suppliers and contractors, a change in behavior more than a change in the law is needed. For example, if banks were to maintain the value of the collateral requirement to at most fifty percent (50%) of the amount applied for depositors who have established a sound credit background with it, while maintaining the waiver of excussion, it would allow these depositors greater accessibility to these instruments without sacrificing the “callable” nature thereof. Moreover, the motivation to use this type of security would result in greater business for the bank concerned. Banks may also consider further lowering the value of the collateral, provided that the applicant would back it up with a proportionate deposit. This may be an attainable first step, because actual experience shows that the value of the collateral required by banks may in fact range from a high of eighty percent (80%) to a low of fifty percent (50%), and that there have been instances when banks have waived this requirements for applicants with well-known and sound credit background. Banks have also issued letters of credit and bank guarantees that were supported by actual cash or deposits equivalent to the amount applied for.

It is recommended that the government initiate the practice of lessening the collateral requirement or of adopting a blended form of cash/property collateral through the government financial institutions, because it would be easier to hold dialogues and workshops on the details of such an undertaking with these entities, as well as adopt the relevant public policy on the matter. Initiating this practice with government financing institutions would also provide the government enough room to test it on a small scale basis, such as adopting it only for selected projects. This would enable the government to determine the effect of the recommendation upon the business of the bank concerned, and conclude if it amounts to good practice. Assuming that it does, and assuming that the practice is adopted by government banks on a larger scale, the effect of lowering the bar for collateral requirements would cause private banks to follow suit in order to maintain their competitiveness in the market.

The GPPB and its TSO may serve as the catalyst for this innovation by initiating the dialogues among all the relevant parties, organizing the workshops, and developing the legal instrument that would consolidate all agreements reached thereby.

### ***I. Clear Definition of the Term “Reputable”***

The IRR-A of R.A. 9184, as with other laws before it, provides that a bank guarantee should be confirmed by a “reputable” local bank, that an irrevocable letter of credit should be issued by a “reputable” commercial bank, and that a surety bond should be issued by a “reputable” surety or insurance company.<sup>58</sup> However, the lack of any clear definition of the term “reputable” has led to various instruments being issued by illegitimate or fly-by-night institutions or companies, particularly in the case of bonding companies. In turn, this has led some in government to believe that GSIS surety bonds are the safer alternative. It is thus clear that the term “reputable” as it

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<sup>58</sup> R.A. 9184, IRR-A, Secs. 27 and 39.

refers to bid and performance securities has to be defined. This should be coupled by a strict implementation by the BACs concerned, so that a bidder who submits a security from a questionable bank, insurance, surety or bonding company would have to be disqualified. It is further recommended that this clarification has to be undertaken through a resolution issued by the GPPB.

#### **J. Clarification on the Posting of Performance Securities**

As pointed out during the interview with the DPWH, an inconsistency exists in the law with respect to the posting of a performance security. In particular, Section 39 of R.A. 9184 provides that a performance security would have to be posted by the winning bidder prior to the signing of the contract, which means that an accessory contract would have to be executed without any principal contract upon which it shall be attached. Although this was further clarified by Section 39 of IRR-A by providing that the performance security would have to be posted upon the signing of the contract, it was opined that the performance security should be furnished at a date that is even later than the perfection of contract, particularly after the issuance of the Notice to Proceed. This issue is now the subject of an ongoing case at the Regional Trial Court level involving a claim by the DPWH against a surety bond issued by Manila Insurance Company. Based on the interview of the proponent, a Motion to Dismiss was filed by the defendant insurance company against the complaint filed by the DPWH, on the ground that the suretyship contract was executed earlier than the date in which the principal contract was signed. It was further argued in the said Motion to Dismiss that, in the absence of a principal contract upon which the alleged suretyship contract could base its existence, the latter should be deemed void and nonexistent.

This inconsistency between R.A. 9184 and its IRR-A has to be rectified. Since the implementing rules are only supposed to fill in the details of an already existing law, it would seem that the former cannot contradict the latter, and would necessarily have to give way in case of a discrepancy. However, further clarification may be found outside R.A. 9184 and in the Civil Code of the Philippines, which provides that a guaranty, being an accessory contract, cannot exist without a valid obligation.<sup>59</sup> Moreover, jurisprudence clearly states that a performance bond merely guarantees the performance of a principal obligation, and that while the principal obligation may stand without such bond, the latter cannot exist without the former, being a mere accessory thereto.<sup>60</sup> For this reason, Section 39 of IRR-A seems to be closer to the provisions of the Civil Code of the Philippines and settled jurisprudence, by providing that the performance security would have to be posted at least upon the signing of the contract. The proponent, however, does not agree with the opinion given by the Legal Officer of the DPWH that the performance security should be furnished at a date that is even later than the perfection of contract, particularly after the issuance of the Notice to Proceed, because the reckoning date should not be the effectivity of the principal contract, but rather the date that it actually comes into existence.

At any rate, a clarification from the GPPB on the matter is in order, as it will help guide BACs and project management offices.

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<sup>59</sup> R.A. 386, Art. 2052.

<sup>60</sup> Brigido R. Valencia v. Rehabilitation Finance Corporation, G.R. No. L-10749 (April 26, 1958).

***K. The Warranty Provision***

As pointed out once more during the interview with the DPWH, the new provision found in Section 62 of R.A. 9184 and its IRR-A on warranty for infrastructure projects after final acceptance, may be not be practical, because it could last for as long as fifteen (15) years. As such, it does not seem to consider the realities of wear and tear and the expense upon the supplier to cover the same with sufficient securities. Moreover, it was opined that the contractor should no longer be held liable for the project once the government has inspected the same and issued its final acceptance thereof, because the contractor cannot be expected to continuously monitor the works for fifteen (15) years.

To make this innovation work, the government has to develop a system that would effectively monitor the use of the constructed works during the warranty period. The government should also look into the practicality of the list of securities required to cover the warranty and the minimum allowable amounts, as these were merely copied from the provision of the IRR-A of R.A. 9184 on performance securities, without necessarily considering the length of time these would have to remain in effect.

In view of the above, the GPPB should study this matter further in close coordination with the agencies that have substantial infrastructure projects, such as the DPWH and the DOTC, as well as with the various contractors' organizations. The results of such a study may then have to be adopted in the form of an amendment to the IRR-A of R.A. 9184.