G.R. No. 238846 (SHELL PHILIPPINES EXPLORATION B.V. and CHEVRON MALAMPAYA LLC, Petitioners, **v. COMMISSION ON AUDIT,** Respondent);

G.R. No. 238852 (PNOC EXPLORATION CORPORATION, Petitioner, **v. COMMISSION ON AUDIT,** Respondent);

G.R. No. 238862 (THELMA M. CERDENA and NORA A. TUAZON, Petitioners, **v. COMMISSION ON AUDIT,** Respondent).

Promulgated: February 25, 2025

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CONCURRING OPINION

LOPEZ, J., *J.*:

I agree with the *ponencia*.

The crux of the controversy is Section 6.3 of the Service Contract No. 38 (Service Contract) executed on December 11, 1990 between the Government of the Republic of the Philippines, represented by then President Corazon C. Aquino, and contractors Occidental Philippines, Inc. and Shell Exploration B.V., predecessors-in-interest of petitioners Shell Exploration B.V. (SPEX), Philippine National Oil Company Exploration Corporation (PNOC-EC), and Chevron Malampaya LLC (Chevron).

Section 6.3 of the Service Contract provides:

> 6.3 *The OFFICE OF ENERGY AFFAIRS shall assume and pay on behalf of CONTRACTOR and its parent company, on the first transaction in each instance where the tax is imposed, all income taxes payable to the Republic of the Philippines based on income and profits* and, with respect to CONTRACTOR, on the first transaction in each instance where the tax is imposed, all dividends, withholding taxes[,] and other taxes imposed by the Government of the Philippines on the distribution of income and profits derived from Petroleum Operations to its parent company. *The OFFICE OF ENERGY AFFAIRS shall promptly furnish to Contractor, without fee or other consideration, the official receipts issued in the name of CONTRACTOR by any duly empowered Government authority, acknowledging the payment of said taxes.* (Emphasis supplied)

This contractual stipulation is based on Section 18(b) of Presidential Decree No. 87 issued in 1972, which states that the Petroleum Board shall "enter into contracts herein authorized with such terms and conditions as may be appropriate under the circumstances including the grant of special allowance [. . .] *Provided, finally, That in no case shall the annual net revenue or share of the GOVERNMENT, including all taxes paid by or on behalf of the*

contractor, be less than sixty percent of the difference between the gross income and the sum of operating expenses and Filipino participation incentive."[1]

Petitioners argue that the above provisions clearly state that the income taxes payable by the contractors under the Service Contract shall be assumed and paid for by the Government, particularly, the Department of Energy (DOE), *on behalf of contractor, and counted as part of the Government's 60% share.*

On the other hand, the Commission on Audit (COA) insists that Section 18(b) of Presidential Decree No. 87 does not clearly state that the income taxes of the contractors are to be assumed by the Government, arguing that the provision only says that the Government's share, including taxes paid by or on behalf of the contractor, cannot be less than 60%. According to COA, this means that the Government's share can be more than 60%, and, therefore, the assumption by the DOE of the contractor's income taxes as part of the Government's 60% share has no legal basis.

Based on this interpretation, COA proceeded to uphold Notice of Charge (NOC) No. 2010-01-151(09) in the amount of PHP 53,140,304,739.86 as under-collection of income taxes from 2002 to December 2009. The NOC instructed the DOE to direct the members of the Service Contract Consortium *to settle immediately the said audit charge.*

While reserving their right to pursue arbitration, SPEX and Chevron, together with their consortium partner, PNOC-EC, filed their *Joint Appeal Memorandum* on March 4, 2011. These appeals were denied via the August 22, 2011 *NGS-Cluster B Decision No. 2011-009*. On October 11, 2011, SPEX and Chevron (along with PNOC-EC) filed their joint *Petition for Review* before the Commission Proper of COA. On May 11, 2015, SPEX and Chevron received COA's assailed April 6, 2015 Decision No. 2015-115 (Decision No. 2015-115) denying the Petitions.

On August 14, 2017, petitioners received from COA another NOC, alleging under collection of taxes from 2015 to 2016 amounting to PHP 16,372,484,686.47. The NOC similarly asked the DOE to direct the members of the Service Contract Consortium "*to settle the said audit charge immediately.*" SPEX and Chevron, together with PNOC-EC, then filed with the COA National Government Sector Cluster 7 their Appeal Memorandum on the NOC. Through the January 24, 2018 Resolution (Decision No. 2018-075), COA denied the Motions for Reconsideration and affirmed the Decision No. 2015-115.

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[1] Presidential Decree No. 87 (1972), sec. 18(b).

The above Decision Nos. 2015-115 and 2018-075 are the subject of these consolidated Petitions.

The above controversy is also the subject of an arbitration initiated by petitioners before the International Chamber of Commerce (ICC) in accordance with the arbitration clause of the Service Contract. The Arbitral Tribunal eventually ruled in favor of petitioners.

In an April 16, 2019 Partial Final Award (Partial Final Award) and December 16, 2019 Final Award (Final Award) (jointly referred to as the ICC Arbitral Award), the ICC Arbitral Tribunal unanimously upheld the DOE's assumption of the contractor's income tax and the inclusion thereof in the Government's 60% share.[2]

However, COA refuses to recognize the jurisdiction of the ICC Arbitral Tribunal, asserting that while it is part of the Government, which is the contracting party in the Service Contract, COA itself is not a party to the Service Contract and its arbitration clause. As such, COA argues that it is not bound by the ICC Arbitral Award. It further asserts that the controversy is not subject to arbitration.

Thus, the same controversy that has been ruled upon by the ICC Arbitral Tribunal is presented before this Court, with the same contract in question.

To be sure, this Court will never shirk away from its mandate or shy away from exercising its jurisdiction. However, considering that there is a claim of arbitrability of the dispute, this Court cannot pass upon the substantive merits of the case without first determining whether the dispute is indeed a matter that should be resolved through arbitration.

The initial query that must be addressed is thus: *May a dispute arising out of an instruction of COA (i.e. to collect under-collected income taxes under the Service Contract) to another government entity or instrumentality bound by an arbitration clause (i.e. DOE), be the subject of arbitration?*

The ICC Arbitral Tribunal's Jurisdiction; arbitrability of the controversy

The Service Contract contains the following arbitration clause:

> 12.1 Disputes, if any, arising between the OFFICE OF ENERGY AFFAIRS and CONTRACTOR relating to this Contract or the interpretation and

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[2] *See ponencia*, pp. 14–17.

> performance of any of the clauses of this Contract, and which cannot be settled amicably, shall be settled by arbitration. The OFFICE OF ENERGY AFFAIRS on the one hand and CONTRACTOR on the other hand, shall each appoint one arbitrator within thirty (30) days after receipt of a written request of the other Party to do so, such arbitrator shall, at the request of the other Party, if the parties do not otherwise agree, be appointed by the President of the International Chamber of Commerce. If an arbitrator fails or is unable to act, his successor will be appointed in the same manner as the arbitrator whom he succeeds. Unless the Parties agree otherwise, the Philippines shall be the venue of the arbitration proceedings. The English language shall be the language used.
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> 12.2 The decision of a majority of the arbitrators shall be final and binding upon the parties. Judgement upon the award rendered may be entered into by any court having jurisdiction or application may be made to such court for a judicial acceptance of the award and an order of enforcement as the case may be.
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> 12.3 Except as provided in this Section, arbitration shall be conducted in accordance with the Rules of Arbitration of the International Chamber of Commerce, then in effect.

The Philippine jurisdiction has long adopted a policy in favor of arbitration. The policy in favor of arbitration has been affirmed in our Civil Code, which was approved as early as 1949. It was later institutionalized by the enactment of Republic Act No. 876, which expressly authorized, made valid, enforceable, and irrevocable parties' decision to submit their controversies, including incidental issues, to arbitration.[3] Indeed, it has long been settled that arbitration should receive every encouragement from the courts which may be extended without contravening sound public policy or settled law.[4] Hence, arbitration clauses are liberally construed to favor arbitration. Any doubt should be resolved in favor of arbitration.[5] Thus, if there were an interpretation that would render effective an arbitration clause for purposes of avoiding litigation and expediting resolution of the dispute, that interpretation shall be adopted.[6]

As pointed out by SPEX and Chevron, the 1987 Constitution does not proscribe arbitration even for matters subject to the jurisdiction of the COA. Article IX(A), Section 7 of the 1987 Constitution provides as follows:

> Section 7. Each Commission shall decide by a majority vote of all its Members, any case or matter brought before it within sixty days from the date of its submission for decision or resolution. A case or matter is deemed submitted for decision or resolution upon the filing of the last pleading, brief, or memorandum required by the rules of the Commission or by the

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3 *Lanuza, Jr. v. BF Corporation*, 744 Phil. 612, 631 (2014) [Per J. Leonen, Second Division].

4 *Eastboard Navigation, Ltd. v. Ysmael and Company, Inc.*, 102 Phil. 1, 16 (1957) [Per J. Bautista Angelo, *En Banc*].

5 *LM Power Engineering Corporation v. Capitol Industrial Construction Groups, Inc.*, 447 Phi. 705, 714 (2003) [Per J. Panganiban, Third Division].

6 *Lanuza, Jr. v. BF Corporation*, 744 Phil. 612, 633 (2014) [Per J. Leonen, Second Division].

> Commission itself. *Unless otherwise provided* by this Constitution or *by law*, any decision, order, or ruling of each Commission may be brought to the Supreme Court on certiorari by the aggrieved party within thirty days from receipt of a copy thereof. (Emphasis supplied)

The 1987 Constitution is thus clear. A petition for *certiorari* is *not* the sole and exclusive means by which a COA Decision may be assailed as the 1987 Constitution grants the legislature and the Supreme Court leeway to provide for other remedies. The Alternative Dispute Resolution (ADR) Act does not specifically exclude COA from its coverage of arbitration. There is no basis for any claimed blanket proscription against arbitration whenever the COA is involved. The ADR Act is a law that provides an alternative means of adjudicating the correctness even of COA actions or decisions. The same can be said of the New York Convention and the Model Law, which have been adopted as part of the law of the land and are recognized as a source of binding legal obligations.

Indeed, this Court already had the opportunity to pronounce that "*other tribunals/adjudicative bodies, too, may have concurrent jurisdiction with the COA over money claims against the government or in the audit of the funds of government agencies and instrumentalities.*"[7]

More, COA's argument that COA Decisions are not covered by the arbitration clause in Section 12.1 of the Service Contract on the ground that COA is not a party to the contract is debunked by the fact that even COA is bound to respect the rulings of regular courts (or arbitral tribunals), even on matters that were the subject of COA rulings.

In *Taisei Shimizu Joint Venture v. Commission on Audit*,[8] this Court reiterated that although COA exercises broad powers pertaining to audit matters, it is devoid of authority to determine the validity of contracts, lest it encroaches upon such judicial function, and it further decreed that the COA's jurisdiction is limited to audit matters only.[9] Hence, it is not unusual for the government and its instrumentalities to be sued in the regular courts (or even arbitral tribunals) even when the action involves government funds or property since such an action may entail resolution of issues falling within the jurisdiction of the courts or arbitral tribunals. *As such, COA is bound to respect the rulings of regular courts (or arbitral tribunals) and stay its hands from modifying said rulings, let alone from claiming exclusive jurisdiction over the case*:

> Actions against the State are not excluded from the jurisdiction of courts. For although, as a rule, the State is immune from suit, it is settled

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7 *Taisei Shimizu Joint Venture v. Commission on Audit*, 873 Phil. 323, 342 (2020) [Per J. Lazaro-Javier, *En Banc*]. (Emphasis supplied)

8 *Id.*

9 *Id.* at 341.

that "a suit against the State is allowed when the State gives its consent, either expressly or impliedly. Express consent is given through a statute, while implied consent is given when the State enters into a contract or commences litigation."

We recently held that although the COA exercises broad powers pertaining to audit matters, it is devoid of authority to determine the validity of contracts, lest it encroaches upon such judicial function. We further decreed that the COA's jurisdiction is limited to audit matters only. Hence, we set aside a ruling of the COA disapproving a deed of exchange between the City Government of Cebu and a private corporation. The case clearly demonstrated why it was not unusual for the government and its instrumentalities to be sued in the regular courts even when the action involved government funds or property since such an action may entail resolution of issues falling within the jurisdiction of the courts.

Other tribunals/adjudicative bodies, too, may have concurrent jurisdiction with the COA over money claims against the government or in the audit of the funds of government agencies and instrumentalities.

In *Development Bank of the Philippines v. COA*, we held that under existing laws, the COA does not have the sole and exclusive power to examine and audit government banks. The Central Bank has concurrent jurisdiction to examine and audit, or cause the examination and audit, of government banks. Neither was there any statutory obstacle for a government bank to hire a private external auditor to examine its accounts without prejudice to its being concurrently subject to a COA audit. The Court took into account, among others, the Constitutional Commission's deliberations showing that the framers of the Constitution downvoted a proposal to add the word "exclusive" to describe the powers of the COA under Article IX-D, Section 2(1) of the 1987 Constitution. It also cannot be said, therefore, that the COA's "power, authority, and duty to [. . .] settle all accounts pertaining to the revenue and receipts of, and expenditures or uses of funds and property, owned or held in trust by, or pertaining to, the Government" is exclusive.

Further, *Civil Service Commission (CSC) v. Pobre* recognized a specific case over which the CSC and the COA each had a role in processing the leave benefits of public officers and employees, requiring the expenditure and use of funds, thus:

> While the determination of leave benefits is within the functions of the CSC as the central personnel agency of the government, the duty to examine accounts and expenditures relating to such benefits properly pertains to the COA. Where government expenditures or use of funds is involved, the CSC cannot claim exclusive jurisdiction simply because leave matters are involved. Thus, even as we recognize CSC's jurisdiction in this case, its power is not exclusive as it is shared with the COA.

There, the Court reversed the ruling of the Court of Appeals that the COA had sole jurisdiction over the matter of computing a government employee's terminal leave benefits.

> Later, *Pobre* would be cited in *De Jesus v. Civil Service Commission* where we held that although the COA had primary jurisdiction to determine the legality and regularity of the grant of allowances and benefits to members of the boards of water districts designated by the Local Water Utilities Administration (LWUA), the CSC similarly had jurisdiction to pass upon the issue in relation to an administrative case against LWUA officers for violation of the Code of Conduct and Ethical Standards for Public Officials and Employees.
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> In the recent case of *Tourism Infrastructure and Enterprise Zone Authority (TIEZA) v. Global-V Builders Co.*, the Court ruled that where TIEZA and the private contractor validly agreed to submit their construction dispute to arbitration, the CIAC properly exercised its jurisdiction over the case.
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> . . . .
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> Considering that TSJV and DOTr had voluntarily invoked CIAC's jurisdiction, the power to hear and decide the present case has thereby been solely vested in the CIAC to the exclusion of COA. Being a specific law, EO No. 1008 providing for CIAC's exclusive jurisdiction prevails over PD 1445, granting the COA the general jurisdiction over money claims due from or owing to the government. For this reason alone, the COA should have stayed its hands from modifying the CIAC's final arbitral award here, let alone from claiming exclusive jurisdiction over the case.[10] (Emphasis supplied, citations omitted)

The foregoing shows that while COA exercises broad powers pertaining to audit matters, its jurisdiction is limited to audit matters only. COA is still bound by, and cannot unilaterally ignore or refuse to recognize or declare as invalid, existing laws.

It is incorrect for COA to claim that while the Government is a party to the Service Contract, this should not include COA upon the mere claim that such would mean that COA would be estopped from questioning the validity, legality, and reasonableness of government contracts.

In *Cagayan de Oro City Water District v. Judge Pasal*,[11] this Court held that a COA recommendation does not preclude the parties from submitting to arbitration. It even pronounced that the proper action for a government entity that is bound by an arbitration clause, when faced with a COA recommendation, is to submit to arbitration:

> COA's recommendation does not preclude the parties from submitting to arbitration. On the contrary, COWD should, even more, submit to arbitration in order to pursue the nullification of the contract itself.

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[10] *Id.* at 341–344.

[11] 914 Phil. 403 (2021) [Per J. Lazaro-Javier, First Division].

> To repeat, the arbitral tribunal has the first opportunity to rule on whether it has jurisdiction to decide a dispute submitted for its resolution, including the validity of the contract itself. This is clear from Article 19 of the BWSA which clearly states that among the arbitrable issues is the nullity of the BWSA itself, thus:
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> 19.02 Amicable Settlement
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> [. . . .]
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> (c) In the event that there is any disagreement, dispute, controversy, claim[,] or difference of any kind whatsoever arising out of or relating to this Agreement or any arrangement relating thereto or contemplated herein, or breach or termination or invalidity hereof, or dispute in the interpretation of any provision hereof (the Dispute), the Parties shall endeavor to resolve such Dispute in the first instance by mutual discussion between them[. . .]
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> [. . . .]
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> 19.03 Arbitration
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> [. . . .]
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> (c) Any Dispute that is not resolved as provided in Section 19.02 shall be finally settled by arbitration in accordance with the provisions of the Arbitration Law of the Republic of the Philippines.
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> [. . . .]
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> Thus, if COWD is truly minded to follow COA's recommendation to initiate the nullification of the BWSA and Supplemental Agreement, the proper forum, therefore, is the arbitral tribunal it ought to constitute together with Rio Verde.[12] (Emphasis supplied)

In the instant case, COA asked the DOE to direct the members of the Service Contract Consortium "*to settle immediately the said audit charge.*" In other words, COA directed the DOE to act in a certain way. Hence and since the Government itself did not initiate arbitration, SPEX and Chevron were well within their rights to initiate arbitration to resolve the issues brought about by COA's directives.

Clearly, a dispute arising out of a COA action or decision is arbitrable. It may be the subject of arbitration proceedings and even COA is bound by the tribunal's ruling as the principle of conclusiveness of prior adjudications is not confined in its operation to the judgments of courts, but extends as well to those of all other tribunals exercising adjudicatory powers.[13]

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12 *Id.* at 424–425.

13 *Taisei Shimizu Joint Venture v. Commission on Audit*, 873 Phil. 323, 348 (2020) [Per J. Lazaro-Javier, *En Banc*].

The State has adopted a policy in favor of and for the active promotion of arbitration. Part of this State policy is not only preference for referral of disputes to arbitration but also respect for the *autonomy* of arbitration proceedings.[14] Such autonomy is reflected, among others, in the principles that provide for the greatest cooperation of and the least intervention from the courts:[15]

> Rule 2.1. General policies. — It is the policy of the State to actively promote the use of various modes of ADR and to respect party autonomy or the freedom of the parties to make their own arrangements in the resolution of disputes with the greatest cooperation of and the least intervention from the courts. To this end, the objectives of the Special ADR Rules are to encourage and promote the use of ADR, particularly arbitration and mediation, as an important means to achieve speedy and efficient resolution of disputes, impartial justice, curb a litigious culture and to de-clog court dockets.

The policy to promote the use of arbitration and respect for the *autonomy* of arbitration proceedings recognizes the principle of "*competence-competence*," which means that the arbitral tribunal shall be accorded the first opportunity or competence to rule on the issue of whether or not it has the competence or jurisdiction to decide a dispute submitted to it for decision, including any objection with respect to the existence or validity of the arbitration agreement.[16]

Thus, when a court is asked to rule upon issues affecting the competence or jurisdiction of an arbitral tribunal in a dispute brought before it, the court must generally exercise judicial restraint and defer to the competence or jurisdiction of the arbitral tribunal by allowing the arbitral tribunal the first opportunity to rule upon such issues,[17] thus:

> Rule 2.4. Policy implementing competence-competence principle. — The arbitral tribunal shall be accorded the first opportunity or competence to rule on the issue of whether or not it has the competence or jurisdiction to decide a dispute submitted to it for decision, including any objection with respect to the existence or validity of the arbitration agreement. When a court is asked to rule upon issue/s affecting the competence or jurisdiction of an arbitral tribunal in a dispute brought before it, either before or after the arbitral tribunal is constituted, the court must exercise judicial restraint and defer to the competence or jurisdiction of the arbitral tribunal by allowing the arbitral tribunal the first opportunity to rule upon such issues.
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> Where the court is asked to make a determination of whether the arbitration agreement is null and void, inoperative or incapable of being performed,

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14 *Fruehauf Electronics Philippines Corporation v. Technology Electronics Assembly and Management Pacific Corporation*, 800 Phil. 721, 742 (2016) [Per J. Brion, Second Division].

15 Special Rules of Court on Alternative Dispute Resolution, A.M. No. 07-11-08-SC (2009), Rule 2.1.

16 Special Rules of Court on Alternative Dispute Resolution, A.M. No. 07-11-08-SC (2009), Rule 2.4.

17 *Id.*

> under this policy of judicial restraint, the court must make no more than a *prima facie* determination of that issue.
>
> Unless the court, pursuant to such prima facie determination, concludes that the arbitration agreement is null and void, inoperative[,] or incapable of being performed, the court must suspend the action before it and refer the parties to arbitration pursuant to the arbitration agreement.

In *Cagayan de Oro City Water District*, the principle of "*competence-competence*" was upheld as follows:

> Under the principle of competence-competence, the arbitral tribunal has the first opportunity to rule on whether it has jurisdiction to decide a dispute submitted for its resolution. In other words, whether the trial court acted in grave abuse of discretion or otherwise grievously erred in directing COWD and Rio Verde to submit to arbitration is for the arbitral tribunal itself to determine, not the Court.
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> . . . .
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> To repeat, only after the arbitral tribunal shall have already ruled on the issue of jurisdiction may the aggrieved party seek judicial recourse against submitting itself to the process of arbitration. Leapfrogging the judicial process in clear defiance of the Special Rules on ADR violates the principle of competence-competence and the State policy to actively promote the use of alternative modes of dispute resolution.[18]

Given that there is no basis to declare that the arbitration clause in the Service Contract is void and inoperative, or that the dispute regarding COA's actions is not arbitrable, respect for the principle of *competence-competence* behooves this Court to defer to the proper arbitral tribunals.

This Court thus finds that the dispute arising from the actions of COA is subject to arbitration under the Service Contract and the merits of the dispute are matters that are within the competence of the appropriate tribunals in the ICC and International Centre for Settlement of Investment Disputes (ICSID) arbitrations.

With this finding, this Court can defer to the findings and rulings of the ICC Arbitral Tribunal.

The applicable rules provide for the autonomy of arbitral awards and emphasize that the courts shall not disturb the arbitral tribunal's determination of facts and/or interpretation of law.[19] An arbitral award enjoys the

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18 914 Phil. 403, 419–420 (2021) [Per J. Lazaro-Javier, First Division].

19 Special Rules of Court on Alternative Dispute Resolution, A.M. No. 07-11-08-SC (2009), Rule 11.9.

presumption that it was made and released in due course of arbitration and is ultimately subject to confirmation by the court in the proper proceeding.

It must be noted that the ICC Arbitral Award has become final and executory because there is no appeal on an international commercial arbitration award. Rule 19.7 of the Special ADR Rules states that an arbitral award is "final and binding" and no appeal or *certiorari* on the merits of an arbitral award is available:

> Rule 19.7. *No appeal or certiorari on the merits of an arbitral award.* — An agreement to refer a dispute to arbitration shall mean that the *arbitral award shall be final and binding.*
>
> Consequently, *a party to an arbitration is precluded from filing an appeal or a petition for certiorari questioning the merits of an arbitral award.* (Emphasis supplied)

More, the ICC Rules of Arbitration provide that "[e]very award shall be binding on the parties" and "*the parties undertake to carry out any award without delay*."[20] Even the *Final Award* stated that the ICC Arbitral Award is "*immediately enforceable*:"

> VIII. AWARD
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> 124. The Tribunal has carefully considered the Parties' arguments in their written pleadings and oral submissions. For all of the foregoing reasons and rejecting all submissions to the contrary, the Tribunal hereby FINDS, DECLARES AND AWARDS as follows:
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> [. . . .]
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> (c) The Tribunal's Partial Final Award and Final Award are *immediately enforceable* notwithstanding the availability or pendency of any other proceeding or application, including an action to set the award aside[.][21]

The ICC Tribunal Award

In the April 16, 2019 *Partial Final Award* and the December 16, 2019 *Final Award*, the ICC Tribunal unanimously upheld the "tax assumption" and the inclusion of the contractor's income tax in the Government's 60% share. Interpreting Section 6.3 of the Service Contract, the ICC Tribunal ruled that COA NOC breached the Service Contract:

> 203. Since Section 6.3 [of Service Contract No. 38] expressly requires the DOE to 'assume and pay' the Contractor's income taxes, and Section 7.4 [of Service Contract No. 38] entitles the Contractor to 40% of Net Proceeds,

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20 ICC Rules, Rule 34(6).

21 *See* Final Award, par. 124(c).

> the value of *the Contractor's income taxes can only form part of the DOE's 60% share of Net Proceeds. There is no other way to read these provisions together and give them all meaning.*
>
> [. . . .]
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> 206. This interpretation also *comports with the implementing legislation* which specifies that *the Government's share of net proceeds "including all taxes paid by or on behalf of the contractor" cannot be less than 60%.*
>
> [. . .]
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> 245. Having determined that *Section 6.3 is valid and enforceable under Philippine law*, the Tribunal finds that the Respondent, through the COA's four Notices of Charge attempting to recover up to approximately USD 3.4 billion from the Consortium representing alleged-under collection of the Government's share, has *clearly breached Section 6.3 of [Service Contract No. 38], a contractual obligation having 'the force of the law' and which must be 'complied with in good faith'*."[22] (Emphasis supplied)

The ICC Arbitral Tribunal also ruled that the Government already received in full its 60% share:

> 222. For the foregoing reasons, *the Tribunal, without any hesitation, finds that the Philippine income taxes paid by or on behalf of the Claimants under [Service Contract No.38] forms part of the Respondent's 60% share of the net proceeds* from petroleum operations carried out under the Contract and the so-called limiting words in no way limit the Philippines' assume and pay obligation.
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> 223. In the circumstances, *the Tribunal also finds that the Respondent has already received in full its 60 percent share of the net proceeds from 2002 until the conclusion of the Hearing in September 2018.* The Tribunal notes that this was, at no time, disputed by the Respondent. Accordingly, the Respondent cannot demand or collect any additional amount from the Claimants for income taxes during this period.[23]

Notably, the Malampaya Project was commissioned in 2001 and began commercial operations in 2002. Since then, it has been producing natural gas that has been used by power plants to generate electricity for Luzon. For the period 2002 to 2015, the Malampaya Project fueled as much as 40% of Luzon's power needs. Today, its fuels about 20% of Luzon's power needs. Indeed, this is the desired outcome of the incentives designed in Presidential Decree No. 87.

Indubitably, the Malampaya Project is the fruit of the policy framework, incentives and efforts made by the Philippines across many decades and different administrations. From the groundwork laid down by Presidential Decree No. 87 and similar laws in the 1970s, the promotional campaigns in

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[22] *See* ICC Partial Final Award, pars. 203, 206, and 245.
[23] *See* ICC Partial Final Award, pars. 222 and 223.

the late 1980s and early 1990s, and the contract implementation in the 2000s – all these contributed to a successful outcome that continues to enhance the country's energy security and economic development.

It is further important to emphasize that a fiscal incentive where the Government assumes the contractor's income tax is not invalid. The assumption of income taxes and its inclusion in the Government's share is not an unusual fiscal incentive.

This was also adopted and implemented in the geothermal industry. In the case of *Republic v. Kidapawan*,[24] which involved a Service Contract under Presidential Decree No. 1442, this Court recognized the assumption of taxes by the Government and its inclusion in the 60% share of the Government:

> Likewise, although it is the government which actually pays the income taxes, the contract nonetheless specifically provided that *the payment is for and in behalf of PNOC-EDC and is chargeable against the 60% share of the government in the net profits derived by the PNOC-EDC arising from the geothermal operation.* In reality, *the PNOC-EDC is the actual payee while the government is only its agent in the payment of the income taxes*. In fact, the official receipt is being issued in the name of PNOC-EDC.[25] (Emphasis supplied)

This is also present in the mining industry. In *La Bugal-B'Laan Tribal Assoc., Inc. v. Ramos*,[26] a case involving mining contracts under Republic Act No. 7942 (the Philippine Mining Act of 1995), this Court recognized that the *share of the Government includes income tax*:

> *The basic government share is comprised of all direct taxes*, fees[,] and royalties, as well as other payments made by the contractor during the term of the FTAA. *These are amounts paid directly to (i) the national government (through the Bureau of Internal Revenue*, Bureau of Customs, Mines & Geosciences Bureau and other national government agencies imposing taxes or fees), (ii) the local government units where the mining activity is conducted, and (iii) persons and communities directly affected by the mining project. The major taxes and other payments constituting the *basic government share* are enumerated below:
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> . . . .
>
> - *Contractor income tax – maximum of 32 percent of taxable income for corporations*[.][27] (Emphasis supplied)

At least three pieces of legislation directed that taxes are part of the Government's share in petroleum projects:

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24 513 Phil. 440 (2005) [Per J. Ynares-Santiago, First Division].
25 *Id.* at 450.
26 486 Phil. 754 (2004) [Per J. Panganiban, *En Banc*].
27 *Id.* at 847.

1. Section 18(b) of Presidential Decree No. 87, otherwise known as the *Oil Exploration and Development Act of 1972*, categorically refers to the Government's share as "*including all taxes paid by or on behalf of the contractor*."

> "(b) Enter into contracts herein authorized with such terms and conditions as may be appropriate under the circumstances including the grant of special allowance . . . Provided, finally, That in no case shall *the annual net revenue or share of the Government, including all taxes paid by or on behalf of the contractor, be less than sixty per cent* of the difference between the gross income and the sum of operating expenses and Filipino participation incentive."

2. Section 12(a)(i)(2) of Presidential Decree No. 1206, *Creating the Department of Energy*, states the Government's share is "*including all taxes paid by or on behalf of the contractor*:"

> "(2) Enter into contracts herein authorized with such terms and conditions as may be appropriate under the circumstances: . . . And, Provided, finally, That in no case shall the annual net revenue or *share of the government, including all taxes paid by or on behalf of the contractor, be less than sixty percent* of the difference between the gross income and the sum of operating expenses and Filipino participation incentive."

3. Section 1(a) of Presidential Decree No. 1459, *Act Authorizing the Secretary of Energy to Enter Into and Conclude or Re-negotiate and Modify Existing Contracts Subject to Certain Limitations*, provides that the Government's share is "*including all taxes*."

> (a) *The share of the Government, including all taxes, shall not be less than sixty per cent* of the difference between the gross income and the sum of operating expenses and such allowances as the Secretary of Energy may deem proper to grant.

Such "tax *assumption*" incentive has been held by this Court to be valid and different from "tax *exemption*."

In *Mitsubishi Corporation-Manila Branch v. Commissioner of Internal Revenue*,[28] this Court ruled in favor of the private contractor's claim for tax refund by virtue of a "tax assumption" clause in an *Exchange of Notes* between Japan and the Philippines. In overturning the Court of Tax Appeals *En Banc* (CTA *En Banc*), this Court explained the difference between "tax *exemption*" and "tax *assumption*" and that the restrictions on "tax *exemption*" *do not apply* in "tax *assumption*:"

> To 'assume' means '[t]o take on, become bound as another is bound, or put oneself in place of another as to an obligation or liability.' This means that *the obligation or liability remains, although the same is merely passed on to a different person.* In this light, *the concept of an assumption is therefore different from an exemption*, the latter being the *'[f]reedom from a duty, liability*[,] *or other requirement'* or '[a] privilege given to a judgment debtor by law, allowing the debtor to retain [a] certain property without liability.' Thus, contrary to the CTA *En Banc*'s opinion, *the constitutional provisions on tax exemptions would not apply*.[29] (Emphasis supplied, citations omitted)

This Court then went on to say that since the Government agreed to *assume* the tax obligation of the contractor, it was erroneous to collect the said tax from the contractor. Therefore, the tax refund was proper.

> In this case, *it is fairly apparent that the subject taxes in the amount of* [*PHP*] *52,612,812.00 was erroneously collected from petitioner, considering that the obligation to pay the same had already been assumed by the Philippine Government* by virtue of its Exchange of Notes with the Japanese Government. Case law explains that an exchange of notes is considered as an executive agreement, which is binding on the State even without Senate concurrence. In *Abaya v. Ebdane*:
>
> [. . . .]
>
> Paragraph 5 (2) of the Exchange of Notes *provides for a tax assumption* provision whereby:
>
> > (2) The Government of the Republic of the Philippines will, itself or through its executing agencies or instrumentalities, assume all fiscal levies or taxes *imposed in the Republic of the Philippines on Japanese firms and nationals* operating as suppliers, contractors or consultants on and/or in connection with any income that may accrue from the supply of products of Japan and services of Japanese nationals to be provided under the Loan.
>
> . . . .
>
> All told, petitioner correctly filed its claim for tax refund under Sections 204 and 229 of the NIRC to recover the erroneously paid taxes

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28 810 Phil. 16 (2017) [Per J. Perlas-Bernabe, First Division].

29 *Id.* at 26.

> amounting to [PHP] 44,288,712.00 as income tax and [PHP] 8,324,100.00 as BPRT from the BIR. *To reiterate, petitioner's entitlement to the refund is based on the tax assumption provision in the Exchange of Notes. Given that this is a case of tax assumption and not an exemption*, the BIR is, therefore, not without recourse; it can properly collect the subject taxes from the NPC as the proper party that assumed petitioner's tax liability.[30] (Emphasis supplied, citations omitted)

It is well to note that various agencies of the Government have likewise affirmed that the "tax assumption" and the inclusion of income tax in the Government share are valid.

More, the BIR, which is the agency tasked to implement tax laws, has stated that tax assumption is "*not novel as it can be found in many financing transactions*." It even recognized that the Republic of the Philippines has assumed taxes in certain bonds it issued. According to November 5, 2012 BIR Ruling No. 604-12:

> As represented, a key feature of the Bonds is the assumption by the Republic of the final withholding tax on interest due on the Bonds. *This 'tax assumption' feature is not novel inasmuch as it can be found in many financing transactions involving Philippine parties*, some of which were the subject of past BIR rulings. For this transaction, *the tax assumption feature was introduced to place the Bonds at par with the bonds issued by the Republic off-shore (commonly referred to as 'ROP Global Bonds')*, with which the Republic undertook to make whole its bond holders from Philippine taxes due on amounts they will receive by making such additional payments necessary to cover Philippine taxes.

Different offices of the Government have maintained that "corporate income tax of the Contractor is a proper inclusion to and/or forms part of the 60% share of the Government."[31]

The foregoing shows that the ICC Tribunal Award is consistent with State policy as it is with this Court's own pronouncements in jurisprudence, legislation, other similar contracts in the geothermal industry and mining industry, as well as the position of various agencies of the Government. Even COA accepted the implementation of the tax assumption incentive for decades, until it recently decided to change its view.

More, Article III, Section 10 of the 1987 Philippine Constitution directs "[n]o law impairing the obligation of contracts shall be passed." This provision "*ensures that the integrity of contracts is protected from any unwarranted State inference.*"[32] It is supposed "to encourage trade and credit

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30 *Id.* at 25–30.

31 *See* Partial Final Award.

32 *Banco De Oro Unibank, Inc. v. International Copra Export Corporation*, 901 Phil. 88, 120 (2021) [Per J. Leonen, Third Division].

by promoting confidence in the stability of contractual relations."[33] Indeed, "[a]s a rule, *contracts should not be tampered with* by subsequent laws that would change or modify the rights and obligations of the parties. As noted by Justice Isagani A. Cruz, '[T]he will of the obligor and obligee must be observed; the obligation of their contract must not be impaired.'"[34]

This constitutional proscription is violated if the State changes the terms of the contract or imposes new conditions:

> There is an impairment when, either by statute or any administrative rule issued in the exercise of the agency's quasi-legislative power, the terms of the contracts are changed either in the time or mode of the performance of the obligation. There is likewise impairment when new conditions are imposed or existing conditions are dispensed with.[35] (Citations omitted)

Verily, "Impairment is anything that diminishes the efficacy of the contract."[36] As explained in *Clemons v. Nolting*:[37]

> Under the Civil Code the contract constitutes the law of the parties unless it violates some provision of law or public policy. The parties themselves make the law by which they shall be governed, and it is the business of the courts to see that the parties to a legal contract comply with its terms. *A law which changes the terms of a legal contract between parties, either in the time or mode of performance, or imposes new conditions, or dispenses with those expressed, or authorizes for its satisfaction something different from that provided in its terms, is law which impairs the obligation of a contract and is therefore null and void. An interference with the terms of a legal contract by legislation is unwarranted and illegal.* A contract is not fulfilled by the delivery of one thing which is different from the thing the contract provides for. Words in contracts are to be given the meaning which they were understood to have by the parties at the time of the making of the contract. There cannot exist in this jurisdiction one law for debtors and another law for creditors. The genius, the nature, and the spirit of our Government amount to a prohibition of such acts of legislation, and the general principles of law and reason forbid them.[38] (Emphasis supplied)

The 2019 case of *Manila International Airport Authority v. Commission on Audit*[39] is instructive. In that case, this Court reversed COA for contradicting the intention of the parties when they entered into certain agreements, thus:

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33 *The Provincial Bus Operators Assn. of the Phils. v. DOLE*, 836 Phil. 205, 270 (2018) [Per J. Leonen, *En Banc*]. (Citation omitted)

34 *Siska Development Corp. v. Office of the President of the Phils.*, 301 Phil 678, 684 (1994) [Per J. Quiason, *En Banc*].

35 *The Provincial Bus Operators Assn. of the Phils. v. DOLE*, 836 Phil. 205, 272 (2018) [Per J. Leonen, *En Banc*].

36 *Siska Development Corp. v. Office of the President of the Phils.*, 301 Phil 678, 684 (1994) [Per J. Quiason, *En Banc*].

37 42 Phil. 702 (1922) [Per J. Johnson, *En Banc*].

38 *Id.* at 717.

39 865 Phil. 526 (2019) [Per C.J. Bersamin, *En Banc*].

> The Court finds the action of the COA not only erroneous but also in contravention of the doctrine of *pacta sunt servanda* and, most importantly, *contrary to the intention of the parties in entering into the supplemental agreements.*
>
> To reiterate, the applicable law in interpreting and construing the agreements should be the canons of international law, particularly the doctrine of *pacta sunt servanda. Yet, in affirming the NDs, the COA proposed that the Government negate its accession to the executive agreements without any valid justification.* Obviously, this approach should not be adopted. In *Agustin v. Edu*, we stressed that *"[i]t is not for this country to repudiate a commitment to which it had pledged its word. The concept of pacta sunt servanda stands in the way of such an attitude, which is, moreover, at war with the principle of international morality.*"
>
> [. . .]
>
> *By going against the intention of the parties as to how the cost of man-months should be charged against, as well as the manner of charging items against contingency, and thus affirming the NDs, the COA contravened the Constitution and international law, and thereby gravely abused its discretion amounting to lack or excess of jurisdiction*[.][40] (Emphasis supplied, citation omitted)

Following these principles, Government, including COA, must abide by the agreed terms and conditions of the Service Contract, including Section 6.3.

Further, the protection under the nonimpairment clause of the Constitution is strengthened by Presidential Decree No. 87. Section 12(g) of Presidential Decree No. 87 provides that the *"[r]ights and obligations* in any contract concluded pursuant to this Act shall be deemed as *essential considerations* for the conclusion thereof and *shall not be unilaterally changed or impaired.*" This is also found in Section 6.2(g) of the Service Contract, which states that the "[r]ights and obligations in this Contract shall be deemed as essential consideration for the conclusion thereof and shall not be unilaterally changed or impaired."

All told, this Court has no reason to disturb the ICC Tribunal's determination of facts and/or interpretation of law. I thus join the *ponencia* in granting the consolidated Petitions.

JHOSEP Y. LOPEZ
Associate Justice

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[40] *Id.* at 552–554.