Republic of the Philippines
Department of Finance
Securities and Exchange Commission
SEC Bldg. EDSA, Greenhills, Mandaluyong City

OFFICE OF THE GENERAL COUNSEL

28 November 2007

OGC Opinion No. 07-20
For: Nationality requirement of public utility concessionaire

SANTIAGO & SANTIAGO LAW OFFICES
Ground Floor, Ortigas Building
Ortigas Avenue corner Meralco Avenue
1605 Pasig City

Attention : Atty. Amado M. Santiago, Jr.

Gentlemen:

This refers to your letter dated 20 November 2007 requesting opinion on whether the proposed structure and the equity investment of the members of the Consortium for the Concessionaire qualifies insofar as the ownership requirement for grantees of public utility franchise as provided in Article XII, Section 11 of the Constitution is concerned.

In particular, you are requesting formal confirmation of the following:

1. Pilipinas First is a Philippine national because not less than 60% of its capital stock is owned by a Filipino citizen, Mr. Pangilinan, and a Philippine national, ManCo, which is 100% owned by Filipino citizens;

2. Since Pilipinas First, a Philippine national, will own at least 60% of the outstanding capital stock of Two Rivers, the latter is also a Philippine national;

3. Since Two Rivers will own 60% of the outstanding capital stock of Holdco, Holdco will be a Philippine national;

4. Since Holdco, a Philippine national, will own 100% of the outstanding capital stock of the Concessionaire, the Concessionaire will also be a Philippine national; and

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5. The proposed ownership structure and equity investment of Two Rivers, Pilipinas First and Terna in the Two Rivers-Terna Consortium for its Concessionaire complies with the ownership requirements for grantees of a public utility franchise.

It is the policy of the state to develop a self-reliant and independent national economy effectively controlled by Filipinos.[1] At the same time, the government takes a liberal stance on allowing foreign investors' participation in certain areas of investment. To strike a balance between the two, there are economic sectors where foreign investment or foreign equity shall only be allowed up to a certain extent. One of these is in the operation of public utilities where the permissible maximum foreign equity under the Constitution is forty percent (40%). The nationality requirement for the operation of public utilities is provided for in Article XII of the Constitution, the pertinent provision of which is quoted hereunder:

> "SECTION 11. No franchise, certificate, or any other form of authorization for the operation of a public utility shall be granted except to citizens of the Philippines or to corporations or associations organized under the laws of the Philippines at least sixty per centum of whose capital is owned by such citizens, xxx xxx xxx The participation of foreign investors in the governing body of any public utility enterprise shall be limited to their proportionate share in its capital, and all the executive and managing officers of such corporation or association must be citizens of the Philippines."

Under Section 3(a) of the Foreign Investments Act (R.A. No. 7042, as amended), a Philippine national is defined as:

> "... a citizen of the Philippines or a domestic partnership or association wholly owned by citizens of the Philippines; or *a corporation organized under the laws of the Philippines of which at least sixty percent (60%) of the capital stock outstanding and entitled to vote is owned and held by citizens of the Philippines*; or a trustee of funds for pension or other employee retirement or separation benefits, where the trustee is a Philippine national and at least sixty (60%) of the fund will accrue to the benefit of the Philippine nationals: Provided, That where a corporation and its non-Filipino stockholders own stocks in a Securities and Exchange Commission (SEC) registered enterprise, at least sixty percent (60%) of the capital stocks outstanding and entitled to vote of both corporations must be owned and held by citizens of the Philippines and at least sixty percent (60%) of the members of the Board of Directors of both corporations must be citizens of the Philippines, in order that the corporations shall be considered a Philippine national;" (Italics supplied)

Section 1(b) of the Amended Implementing Rules and Regulations of R.A. No. 7042, as amended expressly states that the "control test" shall be applied to determine whether the foreign equity threshold has been complied with. In order to determine the nationality of a corporation with foreign equity, the Commission employs the "control test," the method which provides as follows:

> *"Shares belonging to corporations or partnerships at least 60% of the capital of which is owned by Filipino citizens shall be considered as of Philippine nationality, but if the*

1 1987 PHILIPPINE CONSTITUTION, Section 19.

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percentage of Filipino ownership in the corporation or partnership is less than 60%, only the number of shares corresponding to such percentage shall be counted as of Philippine nationality. Thus, if 100,000 shares are registered in the name of a corporation or partnership at least 60% of the capital stock or capital, respectively, of which belongs to Filipino citizens, all of said shares shall be recorded as owned by Filipinos. But if less than 60%, or say only 50% of the capital stock or capital of the corporation or partnership, respectively, belongs to Filipino citizens, only 50,000 shares shall be counted as owned by Filipinos and the other 50,000 shares shall be recorded as belonging to aliens." (Emphasis supplied, Justice Opinion, dated January 19, 1989)[1]

Based on the foregoing and on the facts disclosed, this Office is of the opinion that the proposed structure of Two Rivers Pacific Holdings Corporation ("Two Rivers") would seem to satisfy the nationality requirement as called for in the Constitution. Sixty Percent (60%) of Two Rivers will be owned by Pilipinas First Transmission Holdings Corporation ("Pilipinas First"), a corporation registered under Philippine laws whose equity is distributed as follows: Manuel V. Pangilinan-29.4% Preferred Participating shares; Philippine Pacific First Transmission Management Corporation; 30.6% and First Pacific International Limited-40% (a foreign corporation). It is of no moment that the shares issued to the Filipino shareholders are preferred shares since the Constitution does not distinguish between common and preferred shares.[2] Having that in mind, preferred shares shall be included in the computation of the foreign equity cap for domestic corporations.[3] Moreover, Pilipinas First can be said to be a Filipino owned corporation since 60% of its outstanding capital stock is held by a Philipine national, Manny Pangilinan, who is entitled to elect a majority vote of the Board of Directors.

Considering that Pilipinas First is 60% Filipino owned, then it may be deemed Filipino owned. The same can be said of Two Rivers, whose outstanding capital capital stock is Filipino owned. Since Two Rivers will own 60% of the outstanding capital of the Holding Company to be set up by Two Rivers and Terna-Rete Elettrica Nazionale S.p.A (a foreign company), it necessarily follows that the Two Rivers-Terna Holding Company may likewise be deemed a Filipino corporation. Thus, the Two Rivers-Terna Rete Elettrica Nazionale S.p.A consortium may be deemed as a Filipino corporation, which is allowed to own 100% of the outstanding capital stock of the Concessionaire.

It would not be amiss, however, to state at this point that the purpose of the sixty percentum (60%) requirement is to insure that corporations and associations allowed to operate a public utility shall be controlled by Filipinos. It does not suffice to simply say that a corporation is Filipino owned if it is 60% owned by another corporation, which in turn is 60% Filipino owned. It is imperative that beneficial ownership must ultimately be in the hands of Filipinos. Any attempt to defeat the same shall be meted out the sanctions imposed under applicable laws and rules and regulations.

1 SEC Opinion dated 23 March 1993 addressed to Mr, Francis F. How; SEC Opinion dated 23 November 1993 addressed to Messrs. Dominador Almeda and Renato S. Calma.
2 H.S. DE LEON, THE CORPORATION CODE OF THE PHILIPPINES ANNOTATED 67 (2002).
3 Ibid.

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It shall be understood that the foregoing opinion is rendered based solely on the facts and circumstances disclosed and relevant solely to the particular issues raised therein and shall not be used in the nature of a standing rule binding upon the Commission in other cases whether of similar or dissimilar circumstances. If, upon investigation, it will be disclosed that the facts relied upon are different, this opinion shall be rendered null and void.

Very truly yours,

VERNETTE G. UMALI-PACO
General Counsel

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