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

OFFICE OF THE GENERAL COUNSEL

October 29, 2008

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SEC-OGC Opinion No. 08-21
For: Nationality Requirement for Domestic and International Air Commerce

Dear Atty. Paras:

This refers to your letter dated July 8, 2008 requesting opinion on the validity of the increase in foreign capitalization of a domestic freight forwarding corporation ("subject corporation"), which according to you is 40% foreign-owned and with an authorized capital stock of Twelve Million Five Hundred Thousand Pesos (P12,500,000.00). The proposed increase in foreign capitalization is from 40% to 70%.

Your queries are:

1. Is the corporation legally allowed to implement said increase of its foreign ownership without contravening the Constitution and other pertinent laws?

2. In the affirmative, what are the requirements to carry out such increase of foreign ownership?

3. Under such circumstances, is the corporation allowed to engage in both domestic and international freight forwarding?

On October 15, 2008, you filed a second letter asserting that the corporation is not a common carrier and only buys space from shipping lines and airlines. You also disclosed (albeit in conflict with your earlier statement) that the corporation intends to increase its foreign capitalization from 40% to 100% .

After a careful review of the relevant laws and regulations, we answer your first query in the negative. The subject corporation may not increase its foreign capitalization beyond 40% without contravening the Constitution and relevant laws.

Being a freight forwarder, subject corporation is considered an operator of a public utility defined as a business or service engaged in regularly supplying the public with some commodity or service of public consequence, or essential to the general public. As its name indicates, the term implies public use and service to the public.

As an operator of a public utility, the subject corporation must adhere to the requirements found under Article XII, Section 11 of the Constitution which provides:

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; nor shall such franchise, certificate, or authorization be exclusive in character or for a longer period than fifty years. Neither shall any such franchise or right be granted except under the condition that it shall be subject to amendment, alteration, or repeal by the Congress when the common good so requires. The State shall encourage equity participation in public utilities by the general public. 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.

Notably, one of the requisites is that at least sixty percent (60%) of the shareholdings of a public utility corporation must be owned by citizens of the Philippines. Conversely, foreign equity participation in public utility is limited to forty percent (40%).

The fact that subject corporation merely "buys space" from shipping lines and airlines does not take it out of the meaning of a public utility. It is established that the criterion to be used in the determination of a public utility is whether it holds himself or itself out to serve all who wish to avail themselves of the service, notwithstanding that only one or two people actually receive the same.

Further, Section 12 of Republic Act No. 776[1], provides that, *"Except as otherwise provided in the Constitution and existing treaty or treaties, a permit authorizing a person to engage in domestic air commerce and/or air transportation shall be issued only to* ***citizens of the Philippines.***"

One might then ask if engaging in air freight forwarding is tantamount to engaging in domestic air commerce and/or air transportation. We answer in the affirmative.

This is clear from the definition of an air freight forwarder found in Section 1(ll) of Presidential Decree Number 1462 [2], in relation to Section 3(f) of R.A. No. 776, as follows:

"(ll) ***"Air freight forwarder"*** *means any indirect air carrier which, in the ordinary and usual course of its undertaking, assembles and consolidates or provides for assembling and consolidating such property or performs or provides for the performance of break-bulk and distributing operations with respect to consolidated shipments, and its responsible for the transportation of property from the point of receipt to point of destination and utilizes for the whole or any part of such transportation the services of a direct air carrier." (P.D. No. 1462)*

1 An Act to Reorganize the Civil Aeronautics Board and the Civil Aeronautics Administration, to Provide for the Regulation of Civil Aeronautics in the Philippines and Authorizing the Appropriation of Funds Therefor.

2 Amending Certain Sections of Republic Act Seven Hundred and Seventy-Six.

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*(f) **"Air carrier"** means a person who undertakes, whether directly or indirectly, or by a lease or any other arrangements, to engage in air transportation[3] or air commerce[4]. (R.A. No. 776)*

Indubitably, an air freight forwarder is considered an air carrier which, by definition is a person who undertakes to engage in air transportation or air commerce. As such, it must comply with the citizenship requirement found in Section 12 of R.A. No. 776.

An exception to this rule is expressed in Department of Justice Opinion No. 98 (DOJ Opinion No. 98) penned by Justice Secretary Raul Gonzales on November 9, 2004 which reads:

"Accordingly, the citizenship requirement does not apply if there is a provision in the Constitution which exempts such person from the said requirement or if there is a treaty in which the Philippines is a signatory which allows a person to participate in a States' domestic air commerce and/or air transportation without the necessity of complying with any citizenship requirement. For the same reason, it is safe to conclude that the citizenship requirement would come into operation only if such international airfreight forwarder would engage in domestic air commerce and/or air transportation."

Republic Act No. 776[5] provides that *"an air carrier will be classified as a domestic air carrier if (1) it is a citizen of the Philippines, or (2) if it is not a citizen of the Philippines but has been allowed to engage in domestic and/or foreign air transportation, or domestic and/or foreign air commerce by virtue of the provisions of Section 12 of R.A. No. 776, as amended. Thus, if a foreign air carrier is not operating or conducting its business in the country pursuant to the aforesaid Section 12, then it need not comply with the citizenship requirement of R.A. No. 776, as amended. Otherwise stated, the clause 'an air carrier who is not a citizen of the Philippines' found in the definition of domestic air carrier finds operation only when such person has been granted the permit to engage in domestic air commerce and/or air transportation, or domestic and/or foreign air commerce pursuant to Section 12 of R.A. No. 776."*

This opinion is consistent with the previous opinions issued on September 11, 1946 and Opinion Nos. 218 and 71 issued in 1975 and 1976, respectively, wherein the DOJ stated that utility firms engaged exclusively in international commerce are beyond the purview of the constitutional prohibition limiting foreigners from owning more than 40% of the firm.

Applying this opinion, we answer your third query in the negative. A corporation that is not a citizen of the Philippines may not engage in domestic freight forwarding although it is allowed to engage in purely international freight forwarding.

Anent your second query, if the capital stock is not yet fully subscribed, the foreign stockholders may acquire the unsubscribed shares until their total share in the company reaches

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3 Means service or carriage of persons, property, or mail, in whole or in part, by aircraft. (Section 3(h), R.A. No. 776).

4 Means and includes air transportation for pay or hire, the navigation of aircraft in furtherance of a business, or the navigation of aircraft from one place to another for operation in the conduct of a business.

5 Otherwise known as The Civil Aeronautics Act of the Philippines.

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70%. Otherwise, the company may alternatively increase its authorized capital stock[6], and the foreign stockholder/s may subscribe to the increase. To reiterate, this is only allowable if subject corporation engages in purely international freight forwarding.

In either circumstance, the company's paid-up capital should be at least Two Million Pesos (P2,000,000.00), as provided under the rules and regulations observed by the Commission. For your information, please see attached list of requirements for increase of authorized capital stock and increase of foreign equity.

It shall be understood that the foregoing opinion is rendered based solely on the facts and circumstances disclosed in the queries and relevant solely to the particular issues raised therein and shall not be used in the nature of a standing rule binding on 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 considered as null and void.

VERNETTE G. UMALI-PACO
General Counsel

Attached: as stated.

6 In accordance with the Corporation Code and other relevant laws and rules and regulations of the Commission.

SEC REGISTRATION REQUIREMENTS
(as of 5 November 2007)

Note: The following are portions of the SEC Registration Requirements which are relevant in addressing your query. For a complete list, you may log on to our website at http://www.sec.gov.ph.

- All applications and supporting documents must be in six (6) copies and have cover sheets
- Documents signed abroad must be authenticated by the Philippine Embassy or Consulate in the country where signed.
- All audited Financial Statements and special audit reports must be certified by an independent Certified Public Accountant (CPA), with Statement of Representation filed with the SEC. Said Statement must indicate the CPA Cert. No., PRC/BOA No. and the PTR No. of the CPA.
- All applications must indicate the Tax Identification Number (TIN) of the signatories.

Increase of Authorized Capital Stock

Basic Requirements

1. Certificate of Increase of Capital Stock
2. Treasurer's Affidavit certifying the increase of capital stock, the amount subscribed and the amount received as payment
3. List of stockholders as of the date of the meeting approving the increase, indicating the nationalities of the subscribers and their respective subscribed and paid-up capital on the present authorized capital stock, certified by the corporate secretary
4. Amended Articles of Incorporation
5. Directors' Certificate – a notarized document signed by a majority of the directors and the corporate secretary, certifying the amendment of the Articles of Incorporation increasing the authorized capital stock, the votes of the directors and the stockholders, and the date and place of the stockholders' meeting
6. Audited financial statements as of the last fiscal year, stamped received by the SEC and the BIR

Additional Requirements based on kind of payment on subscription, such as

A. **Cash**

1. A report rendered by an independent CPA on the verification of the cash payment on subscription to the increase
2. Copy of the official receipt, deposit slip, bank statement/passbook
3. Trial balance as of the end of the month immediately preceding the submission of the requirements, which includes the additional capital infusion, certified by the company accountant
4. Written waiver of pre-emptive rights by non-subscribing stockholders

Note: Disregard item 1 if payment on subscription is already reflected in the audited financial statements (item 6 of the basic requirements), and said additional capital infusion is reflected in the Cash Flow Statement

B. **Conversion of advances/liabilities to equity**

1. A report rendered by an independent CPA on the verification of the advances to be converted to equity
2. Detailed schedule of the liabilities to be offset, as of the date of trial balance, certified by the company accountant
3. Trial balance as of the end of the month immediately preceding the submission of the requirements, which includes the subject advances/liabilities, certified by the company accountant
4. Deed of Assignment signed by the creditor/subscriber assigning the advances as payment on his subscription

Note: If subject advances are reflected in the audited financial statements (item 6 of the basic requirements), submit a certification from the auditor identifying the creditors and the amount owed to each, in lieu of item 1

C. **Stock dividends**

1. Long form audit report on the audited financial statements (item 6 of the basic requirements), which includes an analysis of the retained earnings account for the last five (5) years.
2. List of stockholders entitled to the stock dividend with their respective outstanding shares and the allocation of the stock dividend, certified by the corporate secretary.
3. Certification by the corporate secretary as to the treatment of the resulting fractional shares, if any

D. **For other forms of property as payment, submit the additional requirements enumerated for registration of stock corporations**

Increase of Foreign Equity (For Corporations registered under the Foreign Investment Act)

Mode of payment:

a. Assignment of Filipino stockholdings to non-Philippine nationals

1. SEC Form No. F-101 or F-102
2. Original copy of the Deed of Assignment

b. Issuance of new stocks from the unsubscribed capital stock

1. SEC Form No. F-101 or F-102
2. Form F-10-1

c. Increase or Decrease of authorized capital stock

1. SEC Form No. F-101 or F-102
2. Requirements for Increase/Decrease of Capital Stock

d. Merger or Consolidation

1. SEC Form No. F-101 or F-102
2. Requirements for merger or consolidation