REPUBLIC OF THE PHILIPPINES
SECURITIES AND EXCHANGE COMMISSION
SEC BUILDING, EDSA, GREENHILLS, CITY OF MANDALUYONG

October 20, 2008

SEC OPINION NO. 08-23
Foreign equity in partly
Nationalized industry
(60-40% Rule)

MR. SEOK WON KANG
General Affairs Manager
HANJIN HEAVY INDUSTRIES &
CONSTRUCTION CO., LTD.
12TH Floor, 1128 University Parkway,
North Bonifacio, Global City
Taguig, Metro Manila

Sir:

This refers to your letter dated July 25, 2008 informing the Commission of your intention to form a corporation (Project Company) which shall participate and share some ground works in undertaking infrastructure projects in Hydroelectric Power Plants. The operation of the Project Company involves exploration, development and utilization of natural resources although its main interest is on **power generation** for the consumption of its own shipyard facilities in the future.

It appears that the proposed industry to be engaged in by the Project Company falls under the category of "*Exploration, development and utilization of natural resources*" *([Art. XII, Sec. 2 of the Constitution]* and Sec. 17 of the Seventh Regular Foreign Investment Negative List on *"Exploration, development and utilization of natural resources"* [Executive Order No. 584, Promulgating the Seventy Regular Foreign Investment Negative List, December 8, 2006] which limit the foreign equity participation to only Forty Percent (40%). The pertinent provisions of the cited laws respectively read thus:

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Article XII of the 1987 Constitution of the Philippines,

> "All lands of the public domain, waters, minerals, coals petroleum, and other mineral oils, all forces of potential energy, fisheries, forests or timber, wildlife, flora and fauna, and other natural resources are owned by the State. With the exception of agricultural lands, all other natural resources shall not be alienated. The exploration, development, and utilization of natural resources shall be under the full control and supervision of the State. The State may directly undertake such activities, or it may enter into co-production, joint venture, or production-sharing agreements, with Filipino citizens or corporations or associations at least sixty per centum of whose capital is owned by such citizens. . . "

Seventh Regular Foreign Investment Negative List

Up to Forty Percent (40%) Foreign Equity

> 17. Exploration, development and utilization of natural resources (Art. XII, Sec. 2 of the Constitution) [Executive Order No. 584, Promulgating the Seventh Regular Foreign Investment Negative List, December 8, 2006].

Equally applicable is the ruling laid down in DOJ OPINION NO. 122, s. 1998, September 30, 1998, [Mr. Guido Alfredo A. Delgado] setting the qualification of persons, whether natural or juridical, who may apply for water permit.

> "Only citizens of the Philippines, of legal age, as well as juridical persons, who are duly qualified by law to exploit and develop water resources, may apply for water permits."

Of equal importance is the Department of Justice Opinion which discussed in depth the allowable foreign equity participation in geothermal power plant operation and direct water extraction in its natural state, to wit:

> "In support of said proposal, it is argued that the constitutional policy enunciating that 'the exploitation, development and, utilization of natural resources shall be under the full control and supervision of the State,' which may, directly, or in co-production, joint venture or production-sharing agreements with Filipino citizens, or corporations or associations at least sixty percent of whose capital is owned by such citizens, applies only to natural resources in its natural state.'
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> Quoting from an Opinion (No. 122, s. 1998) of this Department wherein, resolving the nationality issue in relation to

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the utilization of water under Section 15 of the Water Code of the Philippines, we stated that 'the nationality requirement imposed by the Water Code refers to the privilege 'to appropriate and use water' and . . . mean(s) the extraction of water directly from the natural source,' it is claimed that 'once water have been extracted from its natural source and goes through a man-made contraption, the same is no longer a natural resource; thus, when the same is utilized by the power plant for power generation, such has taken an artificial character and could no longer be classified as utilization of natural resource subject to the constitutional restriction on nationality.

Applying the same reasoning, it is also alleged that when a geothermal power plant utilizes steam to generate power, the act of converting the steam to geothermal energy could not be considered as falling within the constitutional inhibition since the steam has to pass man-made structures, such as scrubbers and pipelines, before it is utilized by the geothermal power plant.

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As this Department has consistently opined, the nationality requirement imposed by the Water Code of the Philippines relative to the exploitation and development of water resources applies to the privilege to appropriate and use water as provided for under Article 9 of the Code, i.e., the extraction of water directly from its natural source, Thus, 'once removed from its natural source the water ceases to be part of the natural resources of the country and may be the subject of ordinary commerce and may even be acquired by foreigners.'

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Applied to the instant case, and construed in relation to the earlier-mentioned constitutional inhibition, it would appear clear that while both waters and geothermal steam are, undoubtedly 'natural resources,' within the meaning of Section 2, Article XII of the present Constitution, hence, their exploitation, development and utilization should be limited to Filipino citizens or corporations or associations at least sixty per centum of the capital of which is owned by Filipino citizens, the utilization thereof can be opened even to foreign nationals, after the same have been extracted from the source by qualified persons or entities. The rationale is because, since they no longer form part of the natural resources of the country, they become subject to ordinary commerce.

A contrary interpretation, i.e., that the removed or extracted natural resources would remain inalienable especially to foreign nationals, can lead to absurd consequences, e.g., that said

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waters and geothermal steam, and any other extracted natural resources, cannot be acquired by foreign nationals for sale within or outside the country, which could not been intended by the framers of the Constitution.

The fact that under the proposal, the non-power components and structures shall be retained and maintained by the government entities concerned is, to us, not only a sufficient compliance of constitutional requirement of 'full control and supervision of the State' in the exploitation, development and utilization of natural resources. It is also an enough safeguard against the evil sought to be avoided by the constitutional reservation, viz:

> . . . With our natural resources, our sources of power and energy, our public lands, and our public utilities, the material basis of the nation's existence, in the hands of aliens over whom the Philippine Government does not have complete control, the Filipinos may soon find themselves deprived of their patrimony and living as it were, in a house that no longer belong to them."

[DOJ OPINION NO. 052, s. 2005, November 22, 2005, Secretary Raphael P.M. Lotilla, Department of Energy]

In sum, the exploration, development and utilization of natural resources should belong to Filipino nationals either as individuals or juridical entities with an equity participation of 60% Filipino and 40% foreign. Non-compliance with this mandated equity structure for exploitation, development and utilization of natural resources is not legally allowable. Philippine natural resources are reserved for the Filipino people. Otherwise, without the indispensable patrimonial reservation "the Filipinos would wake up one day in a land that is no longer ours."

Accordingly, your proposed 100% foreign owned corporation which shall engage in the direct extraction of water resources for the use of your shipyard facilities is not permissible.

Very truly yours,

VERNETTE G. UMALI-PACO
General Counsel

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