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

22 June 2010

SEC-OGC Opinion No. 10-22
Setting up of Servers in the Philippines by a Foreign Corporation

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Attention: **MS. RACHEL P. FOLLOSCO**

Gentlemen:

This refers to your letter dated 21 January 2010 requesting opinion on whether Genibrain Co., Ltd. ("Genibrain") is not deemed to be "doing business" in the Philippines notwithstanding the location of its servers in the Philippines.

You stated in your letter that Genibrain is a foreign corporation duly organized and validly existing by virtue of and under the laws of Korea, with principal address at 3rd Floor, Dongsin Building, 600-2 Sinsa Dong, Gangnam Gu, Seoul, South Korea. As holder of licenses to offer various interactive games accessible through the internet, it publishes several games online, making them available and accessible to interested players anywhere in the world, including the Philippines.

In pursuit of its business, Genibrain plans to set up game servers in the Philippines, which shall be physically located in and connected to the internet through the facilities provided by a value-added service provider such as ePLDT Inc. ("ePLDT"), a company engaged in providing IT infrastructure solutions to entities by providing, among others, co-location spaces, manpower to manage the data centers, and other technical services for the effective operations and proper functioning of servers. In effect, Genibrain does not intend to maintain a fixed place where it can conduct business through representatives and agents.

The sole issue in this query is whether the setting up of these servers constitutes "doing business" in the Philippines, thereby requiring Genibrain to obtain a license.

Section 3(d) of Republic Act No. 7042[1] ("RA 7042") provides the definition of what constitutes "doing business" in the Philippines, to wit:

> "SEC. 3. Definitions. – As used in this Act:
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> x x x
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> d. The phrase "**doing business**" shall include soliciting orders, service contracts, opening offices, whether called "liaison" offices or branches; appointing representatives or distributors domiciled in the Philippines or who in any calendar year stay in the country for a period or periods totaling one hundred eighty [180] days or more; participating in the management, supervision or control of any domestic business, firm, entity or corporation in the Philippines; and any other *act or acts that imply a continuity of commercial dealings or arrangements and contemplate to that extent the performance of acts or works, or the exercise of some of the functions normally incident to, and in progressive prosecution of commercial gain or of the purpose and object of the business organization*: Provided, however, That the phrase "doing business" shall not be deemed to include mere investment as a shareholder by a foreign entity in domestic corporations duly registered to do business, and/or the exercise of rights as such investor; nor having a nominee director or officer to represent its interests in such corporation; nor appointing a representative or distributor domiciled in the Philippines which transacts business in its own name and for its own account;
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> x x x"(emphasis supplied)

In *Mentholatum Co., Inc. vs. Anacleto Mangaliman*,[2] the Supreme Court laid down the jurisprudential test of what constitutes "doing business" in the Philippines for foreign corporations known as the "Twin Characterization Test". Under this test, a foreign corporation is considered to be "doing business" in the Philippines when:

a) The foreign corporation is maintaining or continuing in the Philippines "the body or substance of the business or enterprise for which it was organized or whether it has substantially retired from it and turned it over to another."

b) The foreign corporation is engaged in activities which necessarily imply "a continuity of commercial dealings and arrangements, and contemplates, to that extent, the performance of acts or works or the exercise of some of the functions normally incidental to, and in progressive prosecution of, the purpose and object of its organization."

No general rule or governing principles can be laid down as to what constitutes "doing" or "engaging in" or "transacting" business. Each case must be

[1] Foreign Investment Act of 1991.
[2] G.R. No. L-47701, June 27, 1941.

judged in the light of its own peculiar circumstances.[3] Before considering the issue at hand, it is important to understand the nature of game servers and how they actually work in the field of online gaming. Considering the particular framework, Genibrain will set-up game servers in the Philippines, where such game servers will be physically situated and connected to the internet through ePLDT.

A **game server** is a remotely or locally run server used by game clients to play multiplayer video games. Most video games played over the Internet operate via a connection to a game server. A professional server is a computer that reads data and transmits vast amounts of data as fast as players need it.[4] When a person is playing a game online, the computer connects to the game server. And as the gamer connects to a game server, objects are loaded to the central processing unit that is used by the gamer. Each gamer is considered an individual client since different objects are loaded for each gamer as he progressed in the game.[5] In effect, the server must keep objects in memory while the gamer is online and playing the game.

Anent the first requisite, the setting up of game servers in the Philippines by Genibrain may be considered as "maintaining or continuing in the Philippines the **body or substance** of the business or enterprise. From understanding how game servers work, it can be deduced that setting up servers is necessary and indispensable in the pursuit of business of which Genibrain is engaged in. Thus, it may be deemed as the "body or substance" of the business, as contemplated in the first requisite. Although the setting up of servers does not involve the physical acts or transactions beyond the mere leasing of a specific portion of space in the Philippines to accommodate these servers, these servers shall act as memory storage where the e-game softwares and related data are stored. In effect, Genibrain will use the servers to store various data relative to the games that it will advertise online, making it a vital component of Genibrain's online business.

With regard to the second requisite, one must not only consider the mere act of setting up servers but also its continued presence in the Philippines. In reality, these servers will be in continuous operation while being physically present in the Philippines. Thus, the continued presence of these servers in the Philippines may be construed to mean that Genibrain is "engaged in **activities** which necessarily imply a continuity of commercial dealings." While there are no physical activities because the transactions appear to be processed and consummated in a virtual plane, the physical presence of these servers in the Philippines is essential in the perfection of these online transactions. Once a purchase is made by a gamer online, the data shall be retrieved from these servers.

From the foregoing and considering Genibrain's nature of business in a general perspective and carefully studying its business framework, this Commission

[3] Top-Weld Manufacturing, Inc. vs. ECED, et al., G.R. No. L-44944, 09 August 1985.
[4] Game Server, From Wikipedia, The Free Encyclopedia, http://en.wikipedia.org/wiki/Game_server (last accessed 14 May 2010).
[5] Dedicated Game Servers, http://acme.highpoint.edu/.../Dedicated%20Game%20Servers_2002Fall.pdf (last accessed 14 May 2010.

opines that these two activities, i.e. the setting up of servers and the purchase of games online are intertwined and indispensable in the pursuit of the business of Genibrain. As such, one cannot exist without the other. Although, the act of setting up servers does not *per se* constitute "doing business" in the Philippines, its continuous presence and operation, however, may be construed as "doing business" in the Philippines. More so, the purchase of games online is clearly a commercial transaction which constitutes "doing business" in the Philippines creating earnings and direct profits for the foreign corporation, especially if the particular games are accessed using the game servers located in the Philippines. These commercial transactions will not be possible without the continued presence and operation of these servers. Thus, pursuant to Section 123[6] of the Corporation Code of the Philippines,[7] it is imperative that Genibrain must first obtain a license before setting up servers in the Philippines.

The foregoing opinion rendered is based solely on the facts disclosed in the query 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. 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

[6] SEC. 123. *Definition and rights of foreign corporations.* - For the purposes of this Code, a foreign corporation is one formed, organized or existing under any laws other than those of the Philippines and whose laws allow Filipino citizens and corporations to do business in its own country or state. It shall have the right to transact business in the Philippines after it shall have obtained a license to transact business in this country in accordance with this Code and a certificate of authority from the appropriate government agency.

[7] Batas Pambansa Blg. 68 (1980).