Republic of the Philippines
SECURITIES AND EXCHANGE COMMISSION
SEC Bldg. EDSA, Greenhills, Mandaluyong City

OFFICE OF THE GENERAL COUNSEL

09 December 2010

SEC-OGC Opinion No. 10-31

Foreign ownership in a local mining corporation

Mr. Leonardo A. Civil
Chairman of the Board
Co-O Small Scale Miners Association, Inc.

Thru:

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19-A Strata 2000, Garnet Road
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Sir:

This refers to your 17 March 2009 letter requesting opinion on whether Medusa Mining Ltd. ("MML," for brevity), an Australian company, is violating the Constitution, the Anti-Dummy Law, and other laws regarding the extent of allowable foreign participation in mining activities in our country.

Your letter does not expressly state the type of mining activity that MML is involved in, or what are the terms of the mining concession granted to it by the State. However, from the tenor of your letter, we deduced that it is an investor in a joint venture that is the holder of a mineral production sharing agreement. It appears that MML operates the Co-O underground gold mine located in Surigao del Sur in partnership with PHILSAGA Mining Corporation ("PHILSAGA," for brevity), an ostensibly Filipino corporation. MML, a 100% foreign corporation, owns 40% of this mining joint venture, while PHILSAGA owns the remaining 60% equity. You allege that, contrary to its representations to Philippine authorities, MML in fact owns and controls 100% of PHILSAGA in violation of the constitutional and statutory restrictions on the extent of foreign participation in the exploitation of Philippine mineral resources. In support of this allegation, you submitted the following:

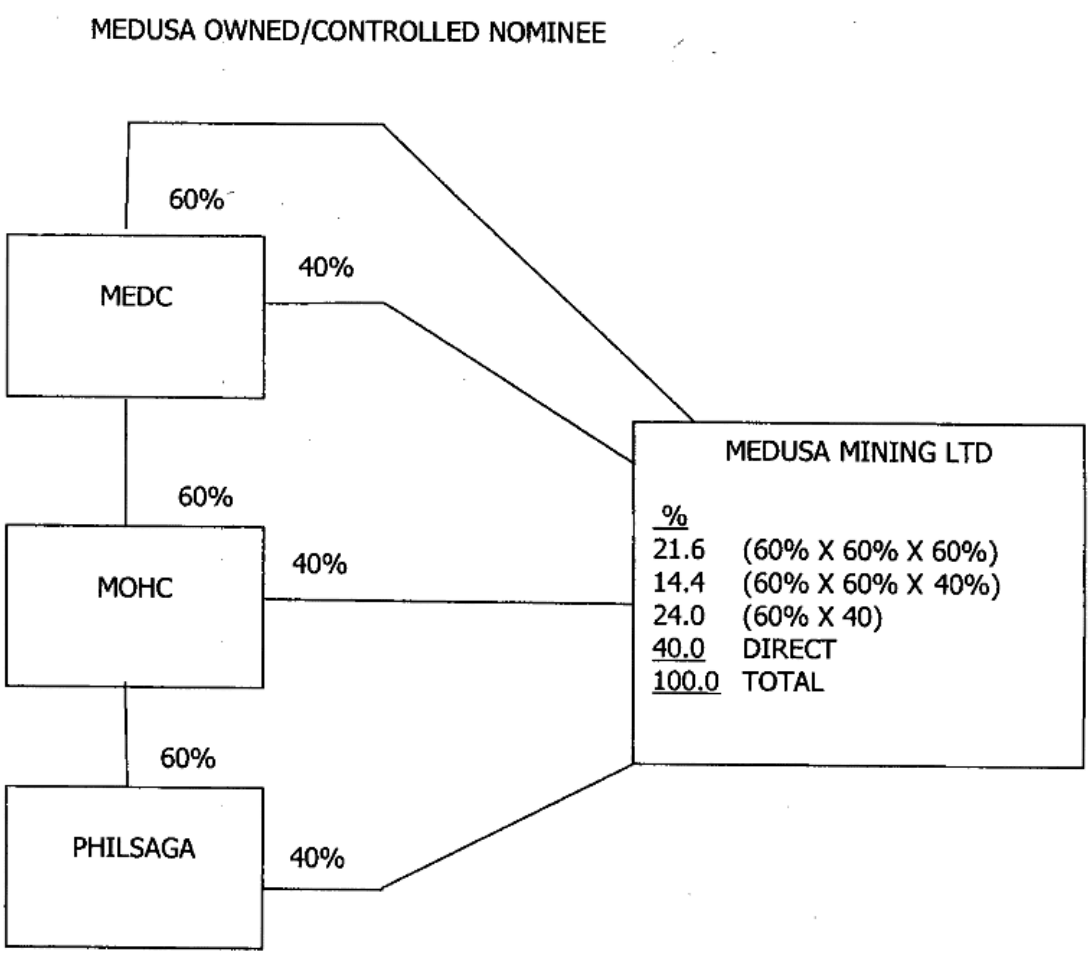
1. Prospectus of PHILSAGA Transaction dated April 26, 2005, Pages 130-134, stating that MML has 100% ownership and control of PHILSAGA.[1]

[1] Annex A of your 17 March 2009 Letter-Request.

2. 2007 and 2008 Audited Financial Statements of MML, specifically notes 23 and 19, which indicate that MML has 78% attributed ownership and 100% control over PHILSAGA.[2] Note 23 further states that MML ownership is structured by a direct 40% ownership and the layering of 60% through Philippine subsidiaries namely, Medusa Exploration & Development Corporation ("MEDC," for brevity) and Medusa Overseas Holding Corporation. ("MOHC," for brevity), which are 100% owned and controlled by MML through a series of existing agreements that deal with the relationship between MML and other shareholders. Thus, it appears that MML in fact owns and controls 100% of PHILSAGA.

You allege that the structure of MML's ownership in PHILSAGA is as follows: (1) MML owns 40% equity in MEDC, while the 60% is ostensibly owned by Philippine individual citizens who are actually MML's controlled nominees; (2) MEDC, in turn, owns 60% equity in MOHC, while MML owns the remaining 40%; (3) Lastly, MOHC owns 60% of PHILSAGA, while MML owns the remaining 40%. You provide the following figure to illustrate this structure:

MEDUSA MINING LTD - 100% PHILSAGA OWNERSHIP



[2] Annexes "B" & "B-1" of your Letter.

The Constitution grants to the State the option to directly undertake mining activities or to enter into the different modes of mining agreements with Filipino citizens, or corporations or associations **at least sixty per centum of whose capital is owned by Filipino *citizens*.**[3]

Under the Philippine Mining Act of 1995,[4] a corporation, partnership, association, or cooperative **at least sixty per cent (60%) of the capital of which is owned by Philippine *citizens*** are qualified as contractors in a mineral production sharing agreement with the State. Sections 3(g) and 3(aq) in relation to Section 26(a) of the statute provide:

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[3] The Constitution, Article XII, Section 2 provides:

> "(a) Section 2. All lands of the public domain, waters, minerals, coal, 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.** Such agreements may be for a period not exceeding twenty-five years, renewable for not more than twenty-five years, and under such terms and conditions as may be provided by law. In cases of water rights for irrigation, water supply fisheries, or industrial uses other than the development of water power, beneficial use may be the measure and limit of the grant.
>
> The State shall protect the nation's marine wealth in its archipelagic waters, territorial sea, and exclusive economic zone, and reserve its use and enjoyment exclusively to Filipino citizens.
>
> The Congress may, by law, allow small-scale utilization of natural resources by Filipino citizens, as well as cooperative fish farming, with priority to subsistence fishermen and fish- workers in rivers, lakes, bays, and lagoons.
>
> The President may enter into agreements with foreign-owned corporations involving either technical or financial assistance for large-scale exploration, development, and utilization of minerals, petroleum, and other mineral oils according to the general terms and conditions provided by law, based on real contributions to the economic growth and general welfare of the country. In such agreements, the State shall promote the development and use of local scientific and technical resources.
>
> The President shall notify the Congress of every contract entered into in accordance with this provision, within thirty days from its execution. 'Financing companies' hereinafter called companies, are corporations, except banks, investments houses, savings and loan associations, insurance companies, cooperatives, and other financial institutions organized or operating under other special laws, which are primarily organized for the purpose of extending credit facilities to consumers and to industrial, commercial, or agricultural enterprises, by direct lending or by discounting or factoring commercial papers or accounts receivable, or by buying and selling contracts, leases, chattel mortgages, or other evidences of indebtedness, or by financial leasing of movable as well as immovable property;"

[4] Republic Act No. 7942 (March 03, 1995).

"Sec. 3 Definition of Terms. As used in and for purposes of this Act, the following terms, whether in singular or plural, shall mean:

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(g) 'Contractor' means a qualified person acting alone or in consortium who is a party to a mineral agreement or to a financial or technical assistance agreement.

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(aq) 'Qualified person' means any citizen of the Philippines with capacity to contract, or a corporation, partnership, association, or cooperative organized or authorized for the purpose of engaging in mining, with technical and financial capability to undertake mineral resources development and duly registered in accordance with law **at least sixty per cent (60%) of the capital of which is owned by *citizens* of the Philippines**: Provided, That a legally organized foreign-owned corporation shall be deemed a qualified person for purposes of granting an exploration permit, financial or technical assistance agreement or mineral processing permit.

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Sec. 26 Modes of Mineral Agreement. For purposes of mining operations, a mineral agreement may take the following forms as herein defined:

(a) Mineral production sharing agreement - is an agreement where the Government grants to the contractor the exclusive right to conduct mining operations within a contract area and shares in the gross output. The contractor shall provide the financing, technology, management and personnel necessary for the implementation of this agreement."

We note that the Constitution and the statute use the concept "Philippine citizens." Article III, Section 1 of the Constitution provides who are Philippine citizens:

"Section 1. The following are citizens of the Philippines:

1. Those who are citizens of the Philippines at the time of the adoption of this Constitution;
2. Those whose fathers or mothers are citizens of the Philippines;
3. Those born before January 17, 1973, of Filipino mothers, who elect Philippine Citizenship upon reaching the age of majority; and
4. Those who are naturalized in accordance with law."

This enumeration is exhaustive. In other words, there can be no other Philippine citizens other than those falling within the enumeration provided by the Constitution. Obviously, only natural persons are susceptible of citizenship. Thus, for purposes of the Constitutional and statutory restrictions on foreign participation in the exploitation of mineral resources, a corporation investing in a mining joint venture can never be considered as a Philippine citizen.

The Supreme Court *En Banc* confirms this view in the case of *Pedro R. Palting, vs. San Jose Petroleum Incorporated.*[5] The Court held that a corporation investing in another corporation engaged in a nationalized activity cannot be considered as a citizen for purposes of the Constitutional provision restricting foreign exploitation of natural resources:

> "Re-stated, the privilege to utilize, exploit, and develop the natural resources of this country was granted, by Article XIII of the Constitution, to Filipino citizens or to corporations or associations 60% of the capital of which is owned by such citizens. With the Parity Amendment to the Constitution, the same right was extended to citizens of the United States and business enterprises owned or controlled directly or indirectly, by citizens of the United States.
>
> There could be no serious doubt as to the meaning of the word "citizens" used in the aforementioned provisions of the Constitution. The right was granted to 2 types of persons: natural persons (Filipino or American citizens) and juridical persons (corporations 60% of which capital is owned by Filipinos and business enterprises owned or controlled directly or indirectly, by citizens of the United States). In American law, "citizen" has been defined as "one who, under the constitution and laws of the United States, has a right to vote for representatives in congress and other public officers, and who is qualified to fill offices in the gift of the people. (1 Bouvier's Law Dictionary, p. 490.) A citizen is —
>
> > One of the sovereign people. A constituent member of the sovereignty, synonymous with the people." (Scott v. Sandford, 19 Ho. [U.S.] 404, 15 L. Ed. 691.)
> >
> > A member of the civil state entitled to all its privileges. (Cooley, Const. Lim. 77. See U.S. v. Cruikshank 92 U.S. 542, 23 L. Ed. 588; Minor v. Happersett 21 Wall. [U.S.] 162, 22 L. Ed. 627.)
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> These concepts clarified, is herein respondent SAN JOSE PETROLEUM an American business enterprise entitled to parity rights in the Philippines? The answer must be in the negative, for the following reasons:

[5] G.R. No. L-14441, December 17, 1966.

Secondly — Neither can it be said that it is indirectly owned and controlled by American citizens through the OIL INVESTMENTS, for this latter corporation is in turn owned and controlled, not by citizens of the United States, but still by two foreign (Venezuelan) corporations, the PANTEPEC OIL COMPANY and PANCOASTAL PETROLEUM.

Thirdly — Although it is claimed that these two last corporations are owned and controlled respectively by 12,373 and 9,979 stockholders residing in the different American states, there is no showing in the certification furnished by respondent that the stockholders of PANCOASTAL or those of them holding the controlling stock, are citizens of the United States.

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Fifthly — But even if the requirements mentioned in the two immediately preceding paragraphs are satisfied, nevertheless, to hold that the set-up disclosed in this case, with a long chain of intervening foreign corporations, comes within the purview of the Parity Amendment regarding business enterprises indirectly owned or controlled by citizens of the United States, is to unduly stretch and strain the language and intent of the law. For, to what extent must the word "indirectly" be carried? Must we trace the ownership or control of these various corporations ad infinitum for the purpose of determining whether the American ownership-control-requirement is satisfied? Add to this the admitted fact that the shares of stock of the PANTEPEC and PANCOASTAL which are allegedly owned or controlled directly by citizens of the United States, are traded in the stock exchange in New York, and you have a situation where it becomes a practical impossibility to determine at any given time, the citizenship of the controlling stock required by the law. In the circumstances, we have to hold that the respondent SAN JOSE PETROLEUM, as presently constituted, is not a business enterprise that is authorized to exercise the parity privileges under the Parity Ordinance, the Laurel-Langley Agreement and the Petroleum Law. Its tie-up with SAN JOSE OIL is, consequently, illegal.

What, then, would be the Status of SAN JOSE OIL, about 90% of whose stock is owned by SAN JOSE PETROLEUM? This is a query which we need not resolve in this case as SAN JOSE OIL is not a party and it is not necessary to do so to dispose of the present controversy. But it is a matter that probably the Solicitor General would want to look into."

In fact, the Supreme Court suggests that a corporation engaging in a nationalized activity must be directly owned by citizens considering the text of the Constitution, and the fact that to allow indirect ownership of citizens through a series of intervening investing corporation would render it almost impossible to determine the citizenship of the natural persons who ultimately own and controls the shares of stock.

The San Jose case, which was decided under the 1935 Constitution is still the prevailing jurisprudence on the matter considering it has not been overturned by another Supreme Court *En Banc* Decision, and the provisions of the present Constitution on nationalized activities is identical to that of the 1935 Constitution

particularly the phrase: "...**Filipino citizens, or corporations or associations at least sixty per centum of whose capital is owned by such citizens.**" The fact that the framers of the present Constitution did not deviate from the words of the 1935 Constitution implies that the framers' intent was for corporations that satisfy the ownership restrictions through direct ownership and control by citizens to be the only ones qualified to engage in a nationalized activity – corporations owned through a series of intervening investing corporations are not qualified. Be that as it may, we will not render an opinion on whether indirect ownership is prohibited considering the Supreme Court has yet to make a definitive ruling on this matter.

Accordingly, we opine that we must look into the citizenship of the individual stockholders, i.e. natural persons, of that investor-corporation in order to determine if the Constitutional and statutory restrictions are complied with. If the shares of stock of the immediate investor corporation is in turn held and controlled by another corporation, then we must look into the citizenship of the individual stockholders of the latter corporation. In other words, if there are layers of intervening corporations investing in a mining joint venture, we must delve into the citizenship of the individual stockholders of each corporation. This is the strict application of the grandfather rule, which the Commission has been consistently applying prior to the 1990s.

Indeed, the framers of the Constitution intended for the "grandfather rule" to apply in case a 60%-40% Filipino-Foreign equity corporation invests in another corporation engaging in an activity where the Constitution restricts foreign participation.[6]

The "grandfather rule" is a method by which the percentage of Filipino equity in corporations engaged in nationalized and/or partly nationalized areas of activities provided for under the Constitution and other national laws is accurately computed, and the diminution of said equity prevented.[7] The "Grandfather Rule" is applied specifically in cases where the corporation has corporate stockholders with alien stockholdings, otherwise, if the rule is not applied, the presence of such corporate stockholders could diminish the effective control of Filipinos.[8]

To show how the "Grandfather Rule" is applied, we reproduce the following part of the opinion of the Department of Justice's ("DOJ," for brevity) Opinion addressed to the Board of Investments on 26 April 1988:

> "Applying the 'Grandfather Rule' in the instant case, the result is as follows:
> Investing Corporation:
> Philippine Corporation 70%
> Foreign Corporation 30%
>
> Philippine Corporation

[6] Bernas, Joaquin, The Intent of the 1986 Constitution Writers, 813 (1995) citing III Record of the Constitutional Commission: Proceedings and Debates 255 (1987).
[7] DOJ OPINION NO. 084, s. 1988 (April 26, 1988) citing SEC Memo, S. 1976.
[8] Id.

Philippine Corporation		70%			
Foreign Corporation	30%				
Philippine Corporation					
Filipino equity		60%			
Foreign equity		40%			
Grandfather Rule:					
Foreign equity		40 x 70	=	28%	
		100			
Add: Percentage of Foreign equity in Investing Corporation				30%	58%
Total Foreign equity:					
Filipino equity:		60 x 70 =			42%
		100		Total	100%

> Considering that, as shown above, the total foreign equity in the investing corporation is 58% while the Filipino equity is only 42%, in the investing corporation, subject of your query, is disqualified from investing in real estate, which is a nationalized activity, as it does not meet the 60%-40% Filipino-Foreign equity requirement under the Constitution."[9]

We are aware of the Commission's prevailing policy of applying the so-called "control test" in determining the extent of foreign equity in a corporation. Since the 1990s, the Commission *En Banc*, on the basis of DOJ Opinion No. 18, series of 1989 dated January 19, 1989, voted and decided to do away with the strict application/computation of the "grandfather rule," and instead applied the "control test" method of determining corporate nationality.[10] The method, as applied in this DOJ Opinion, states:

> "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 percentage of Filipino ownership 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 belong 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."

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[9] Id.
[10] SEC Opinion dated 30 May 1990, re: Gold Fields Philippines Corporation.

"b. 'Philippine national' shall mean a citizen of the Philippines or a domestic partnership or association wholly owned by the 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 percent [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 stock 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 each of both corporation must be citizens of the Philippines, in order that the corporation shall be considered a Philippine national. The control test shall be applied for this purpose.

Compliance with the required Filipino ownership of a corporation shall be determined on the basis of outstanding capital stock whether fully paid or not, but only such stocks which are generally entitled to vote are considered.

For stocks to be deemed owned and held by Philippine citizens or Philippine nationals, mere legal title is not enough to meet the required Filipino equity. Full beneficial ownership of the stocks, coupled with appropriate voting rights is essential. Thus, stocks, the voting rights of which have been assigned or transferred to aliens cannot be considered held by Philippine citizens or Philippine nationals.

Individuals or juridical entities not meeting the aforementioned qualifications are considered as non-Philippine nationals."

However, we now opine that the control test must not be applied in determining if a corporation satisfies the Constitution's citizenship requirements in certain areas of activities. The control test creates a legal fiction where if 60% of the shares of an investing corporation are owned by Philippine citizens then all of the shares or 100% of that corporation's shares are considered Filipino owned for purposes of determining the extent of foreign equity in an investee corporation engaging in an activity restricted to Philippine citizens. In other words, Philippine citizenship is being unduly attributed to foreign individuals who own the rest of the shares in a 60% Filipino equity corporation investing in another corporation. Thus, applying the control test effectively circumvents the Constitutional mandate that corporations engaging in certain activities must be 60% owned by Filipino citizens. The words of the Constitution clearly provide that we must look at the citizenship of the individual/natural person who ultimately owns and controls the shares of stocks of the corporation engaging in the nationalized/partly-nationalized activity. This is what the framers of the constitution intended. In fact, the Mining Act strictly adheres to the text of the Constitution and does not provide for the application of the control test. Indeed, the application of the control test has no constitutional or statutory basis. Its application is only by mere administrative fiat.

Administrative interpretations can never be allowed to derogate from the text and clear intent of the Constitution or the statutes. An administrative practice that is contrary to the constitutional and statutory provisions it implements does not vest any right, and must be discontinued no matter how long such practice has been prevalent. The practice of applying the control test in determining the extent of foreign participation in nationalized areas of activities must be discontinued since it actually allows corporations where the level of Filipino ownership and control is effectively less than 60% to engage in activities reserved by the Constitution to Philippine citizens or corporation that are 60% owned by Philippine citizens. In other words, the control test effectively sanctions the circumvention of the Constitutional restriction.

In any case, we opine further that the Constitution and the statute require that sixty per cent (60%) of the capital of a mining corporation must be owned by Philippine **"citizens"** and not just Philippine "nationals" as used in other statutes such as the FIA.[12] In other words, the term "Philippine national" as used in the FIA is not synonymous or equivalent to the concept of "Philippine citizen" as used in the Constitution and the Mining Act. The term "Philippine national" as defined under the FIA and its implementing rules is only applicable to entities that want to register and derive benefits under the FIA. It does not apply to entities engaging in nationalized activities or activities in the so called "negative lists."

Having established that the application of the grandfather rule, instead of the control test, is the standard consistent with the provisions of the Constitutional and the Mining Act restricting foreign participation in a mineral production sharing agreement, we now apply the grandfather rule to the joint mining venture:

Joint Mining Venture	
Filipino equity (Philsaga)	60%
Foreign equity (MML)	40%
Philsaga (investing corporation)	
Philippine Corporation (MOHC)	60%
Foreign Corporation (MML)	40%
MOHC (investing corporation)	
Philippine Corporation (MEDC)	60%
Foreign Corporation (MML)	40%
MEDC (investing corporation)	
Philippine citizens	60%
Foreign Corporation (MML)	40%

[12] Republic Act No. 7042 as amended by Republic Act No. 8179 (1996).

Foreign Corporation (MML)	40%		
MEDC (investing corporation)			
Philippine citizens	60%		
Foreign Corporation (MML)	40%		
Grandfather Rule:			
Indirect Foreign equity in MOHC	40 x 60 / 100 =	24%	
Add: Percentage of direct Foreign Equity		40%	
		64%	
Indirect Foreign equity in Philsaga		64 x 60 / 100 =	38.4%
Add: Percentage of direct Foreign Equity			40%
			78.4%
Indirect Foreign equity in Joint Mining Venture			78.4 x 60 / 100 = 47.04%
Add: Percentage of direct Foreign Equity			40%
Total Foreign equity:			87.04%
Filipino equity:	60% x 60% x 60% x 60% =		12.96%
		Total	100%

Accordingly, under the structure you represented, the joint mining venture is 87.04 % foreign owned, while it is only 12.96 % owned by Philippine citizens. Thus, the constitutional requirement of 60 % ownership by Philippine citizens is violated.

Further, we understand from your representations and documents submitted that MML's financial statements attribute 100 % control over MOHC and MEDC since

in certain economic activities, are illegal, and the persons responsible for such agreements are criminally liable under the Anti-Dummy Law.[13]

This *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.

Please be guided accordingly.

09 Dec '10 7:35 P.M.

VERNETTE G. UMALI-PACO
General Counsel

[13] Commonwealth Act No. 108, Section 2-A provides:

> "Section 2-A. Any person, corporation, or association, which, having in its name or under its control, a right, franchise, privilege, property or business, the exercise or enjoyment of which is expressly reserved by the Constitution or the laws to citizens of the Philippines or of any other specific country, or to corporations or associations at least sixty per centum of the capital of which is owned by such citizens, permits or allows the use, exploitation or enjoyment thereof by a person, corporation or association not possessing the requisites prescribed by the Constitution or the laws of the Philippines; or leases, or in any other way, transfers or conveys said right, franchise, privilege, property or business to a person, corporation or association not otherwise qualified under the Constitution, or the provisions of the existing laws; or in any manner permits or allows any person, not possessing the qualifications required by the Constitution, or existing laws to acquire, use, exploit or enjoy a right, franchise, privilege, property or business, the exercise and enjoyment of which are expressly reserved by the Constitution or existing laws to citizens of the Philippines or of any other specific country, to intervene in the management, operation, administration or control thereof, whether as an officer, employee or laborer therein with or without remuneration except technical personnel whose employment may be specifically authorized by the Secretary of Justice, and any person who knowingly aids, assists, or abets in the planning, consummation or perpetration of any of the acts herein above enumerated shall be punished by imprisonment for not less than five nor more than fifteen years and by a fine of not less than the value of the right, franchise or privilege enjoyed or acquired in violation of the provisions hereof but in no case less than five thousand pesos: Provided, however, that the president, managers or persons in violating the provisions of this section shall be criminally liable in lieu thereof: Provided, further, That any person, corporation or association shall, in addition to the penalty imposed herein, forfeit such right, franchise, privilege and the property provisions of this Act; and Provided, finally, That the election of aliens as members of the board of directors or governing body of corporations or associations engaging in partially nationalized activities shall be allowed in proportion to their allowable participation or share in the capital of such entities."