

Capitalizing on Capital: The Supreme Court’s *Obiter Dictum* in Defining Capital Under the Constitution

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*An obiter dictum is a nonessential, welcome and sublime like a poem of love in a last will or unwanted and asinine as in brickbats in a funeral oration. It is neither enforceable as a relief nor the source of a judicially actionable claim.*¹

I. INTRODUCTION

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1. Republic v. Nolasco, 457 SCRA 400, 408 (2005).

In a landmark Resolution² issued last 9 October 2012, the Supreme Court *En Banc* denied with finality the Motions for Reconsideration filed in relation to *Gamboa v. Teves*³ and declared that the term “capital” under Section 11, Article XII of the Constitution refers only to the voting stock or the shares of stock entitled to vote in the election of directors.⁴ In fine, this Constitutional Provision mandates that at least 60% of the capital of the operators of public utilities must be owned by Filipino citizens.⁵

However, in the same Resolution, the Supreme Court also went further and ruled that the imposition of such foreign equity limitation must separately apply to each class of shares, whether common, preferred non-voting, preferred voting, or any other class of shares.⁶

Pertinently, the term “capital” is used by the Constitution not only in restricting foreign ownership in the operations of public utilities. The same language also appears in describing the following partly-nationalized activities under the Constitution: ownership of private lands,⁷ exploitation of natural resources,⁸ ownership of educational institutions,⁹ ownership of advertising companies,¹⁰ and other areas of investment that may be reserved for Filipinos.¹¹ Therefore, the Supreme Court’s definition of capital for operators of public utilities under Section 11, Article XII of the Constitution can similarly be applied to the other corporations engaged in partly nationalized activities under the Constitution.

This Comment seeks to shed light on the Constitutional definition of “capital” in view of the recent declaration of the Supreme Court in the Resolution that the foreign equity limitation must separately apply to each class of shares.¹² Specifically, it is submitted that such statement constitutes an *obiter dictum* and should not serve as a binding precedent for purposes of *res judicata*.

2. Heirs of Wilson P. Gamboa v. Teves, 682 SCRA 397 (2012).

3. Gamboa v. Teves, 652 SCRA 690 (2011).

4. *Heirs of Wilson P. Gamboa*, 682 SCRA at 435.

5. *Id.*

6. *Id.* at 445.

7. PHIL. CONST. art. XII, § 7.

8. PHIL. CONST. art. XII, § 2.

9. PHIL. CONST. art. XIV, § 4 (2).

10. PHIL. CONST. art. XVI, § 11 (2).

11. PHIL. CONST. art. XII, § 10.

12. *Heirs of Wilson P. Gamboa*, 682 SCRA at 445.

Moreover, the Author espouses the use of three parameters to define capital under the Constitution, namely: (1) voting stock; (2) beneficial ownership over the voting stock; and (3) total outstanding capital stock.

II. THE CASE OF *GAMBOA V. TEVES*

This Case illustrated the proper method of computing for the percentage of Filipino ownership in an operator of a public utility by providing for a categorical definition of capital under Section 11, Article XII of the Constitution.¹³ Specifically, the public utility operator involved in this case was Philippine Long Distance Telephone Company (PLDT).¹⁴

A. Overview of the Case

On 28 November 1928, the Philippine Legislature enacted Act No. 3436,¹⁵ which established the franchise of PLDT and its right to operate a telecommunications network.¹⁶ Thereafter, in 1969, Philippine Telecommunications Investment Corporation (PTIC), a holding company, acquired 26 million shares of PLDT.¹⁷ This was equivalent to 13.8% of the outstanding capital stock of PLDT.¹⁸

In 1977, Prime Holdings, Inc. acquired 111,415 shares or 46% of PTIC.¹⁹ However, in 1986, the Presidential Commission on Good Government (PCGG) sequestered such shares of PTIC.²⁰ Meanwhile, in 1999, First Pacific Company Limited (FPCL), a foreign-owned investment firm, acquired the remaining 54% of the outstanding capital stock of PTIC.²¹

In 2006, the Philippine government, through the Inter-Agency Privatization Council, declared the sale of the sequestered shares of PTIC through a public bidding.²² FPCL exercised its right of first refusal and purchased the sequestered shares.²³

13. *Gamboa*, 652 SCRA at 723.

14. *Id.* at 699.

15. An Act Granting to the “Philippine Long Distance Telephone Company” a Franchise to Install, Operate, and Maintain a Telephone System Throughout the Philippine Islands, Act No. 3436 (1928).

16. *Gamboa*, 652 SCRA at 699.

17. *Id.* at 701.

18. *Id.*

19. *Id.*

20. *Id.* at 699.

21. *Id.* at 700.

22. *Gamboa*, 652 SCRA at 700.

23. *Id.*

Since PTIC owned 13.8% of the outstanding capital stock of PLDT, the aforementioned purchase of the sequestered shares by FPCL resulted in an increase in its common shareholdings in PLDT from 30.7% to 37%.²⁴ Moreover, since the Japanese firm NTT DOCOMO owned 51.5% of the common stock of PLDT,²⁵ ultimately, the purchase of FPCL led to the total increase in the common shareholdings of foreigners in PLDT to 81.4%.²⁶

In view thereof, Wilson Gamboa filed a petition for prohibition, injunction, declaratory relief, and declaration of nullity of the sale of the sequestered PTIC shares by alleging that the same violated the constitutional limitation on foreign ownership imposed on public utility operators.²⁷

In deciding the petition, the Court refused to rule on the alleged violation of the foreign equity restriction.²⁸ Instead, the Court reiterated the hornbook doctrine that it can only rule on pure questions of law.²⁹ Thus, the resolution of factual issues such as the determination of the validity of the sale of the sequestered PTIC shares was outside the jurisdiction of the Court.³⁰ With this in mind, the Court limited its ruling on the petition to the purely legal question of providing a categorical definition of “capital” under Section 11, Article XII of the Constitution.³¹ Thereafter, the Court directed the Securities and Exchange Commission (SEC), the agency tasked with the duty of regulating corporations engaged in partly nationalized activities, to apply this judicial definition of capital in determining whether there is indeed a violation of Section 11, Article XII of the Constitution.³²

In essence, the Court defined “capital” as the voting stock or the shares of stock entitled to vote in the election of directors.³³ In the case at bar, this referred only to common shares, and not to the total outstanding capital stock of PLDT, which was composed of both common and non-voting preferred shares.³⁴

In its discussion, the Court declared that the Filipinization of public utilities enshrined in Section 11, Article XII of the Constitution is based on

24. *Id.* at 703-04.

25. *Id.* at 704.

26. *Id.*

27. *Id.* at 699 & 704.

28. *See Gamboa*, 652 SCRA at 705-12.

29. *Id.*

30. *Gamboa*, 652 SCRA at 705-06.

31. *Id.* at 710.

32. *Id.* at 743.

33. *Id.* at 723.

34. *Id.*

the state policy of ensuring “a self-reliant and independent national economy effectively controlled by Filipinos.”³⁵ Thereafter, the Court illustrated how effective control can be exercised by Filipino stockholders over public utilities.³⁶

According to the Court, this control is exercised particularly through the vote of the stockholder in the election of the board of directors which directs or manages the operations of the corporation.³⁷ Since common shares cannot be deprived of the right to vote in the election of directors, control is exercised through the ownership of such common shares or voting stock of the corporation.³⁸

On the other hand, preferred shares can be deprived of the right to vote in the election of directors through restrictions imposed in the Articles of Incorporation.³⁹ In this case, ownership over such non-voting shares cannot provide the stockholder with control over the corporation.⁴⁰

Nevertheless, the Court said that once these preferred shares are conferred with the right to vote in the election of directors and consequently become designated as voting shares, then ownership over the same can result in control over the corporation.⁴¹ Since ownership over the voting shares provides corporate control to the stockholder, the Court concluded that “capital” refers to voting stock or shares of stock entitled to vote in the election of directors.⁴²

Furthermore, the Court ruled that this definition breathes life into the intent and letter of the Constitution to ensure effective control of public utilities by Filipino citizens.⁴³ In particular, the Court cited portions of the deliberations of the Constitutional Commission wherein “capital” referred to the voting stock or controlling interest of a corporation.⁴⁴

Finally, the Court made reference to the definition of “Philippine national” adopted by Republic Act (R.A.) No. 7042, otherwise known as

35. PHIL. CONST. art. II, § 19.

36. *Gamboa*, 652 SCRA at 731.

37. *Id.*

38. *Id.* at 726.

39. *Id.* at 725.

40. *Id.*

41. *Id.*

42. *Gamboa*, 652 SCRA at 726.

43. *Id.*

44. *See Gamboa*, 652 SCRA at 726–28.

the Foreign Investments Act of 1991 (FIA),⁴⁵ wherein ownership over the voting stocks was used as basis for determining corporate nationality.⁴⁶

Aside from equating “capital” to voting stocks, the Court also ruled on the need for full beneficial ownership over such voting stocks.⁴⁷ Specifically, the Court cited Section 1 (b) of the Implementing Rules of the FIA,⁴⁸ which provides for the following —

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.⁴⁹

The Court substantially reiterated this Section by declaring that Filipino citizens must possess the legal and beneficial ownership of 60% of the voting stocks in order for the corporation to be deemed a Philippine national —

Mere legal title is insufficient to meet the 60[%] Filipino-owned ‘capital’ required in the Constitution. Full beneficial ownership of 60[%] of the outstanding capital stock, coupled with 60[%] of the voting rights, is required. The legal and beneficial ownership of 60[%] of the outstanding capital stock must rest in the hands of Filipino nationals in accordance with the constitutional mandate. Otherwise, the corporation is ‘considered as non-Philippine national[]’.⁵⁰

Finally, the Court said that adopting a broad definition of capital disregards the significance of the voting stock as a hallmark of corporate control by the stockholder.⁵¹ In the case at bar, the Court cited the 2010 General Information Sheet of PLDT and declared that, on the one hand, 64% of the common shares of PLDT were owned by foreigners.⁵² On the

45. An Act to Promote Foreign Investments, Prescribe the Procedures for Registering Enterprises Doing Business in the Philippines and for Other Purposes [Foreign Investments Act of 1991], Republic Act No. 7042 (1991).

46. *Gamboa*, 652 SCRA at 730.

47. *Id.*

48. Rules and Regulations Implementing the Foreign Investments Act of 1991, Republic Act No. 7042, § 1 (b) (1996).

49. *Id.* § 1 (b) (3).

50. *Gamboa*, 652 SCRA at 730.

51. *Id.* at 735 (citing Securities and Exchange Commission (SEC), Philippine Long Distance Company’s General Information Sheet for the Year 2010, available at [http://www.pldt.com.ph/investor/shareholder/Documents/GIS_2010_\(as%20of%207.2.10\)_final.pdf](http://www.pldt.com.ph/investor/shareholder/Documents/GIS_2010_(as%20of%207.2.10)_final.pdf) (last accessed June 23, 2013)).

52. *Gamboa*, 652 SCRA at 735.

other hand, 99% of the preferred non-voting shares were held by Filipinos.⁵³ Since ownership of the majority of the common shares was in the hands of foreigners, the Court opined that corporate control was exercised by such foreign stockholders.⁵⁴

Since control is exercised through the vote of the stockholder in the election of directors, the foreign equity restriction must be imposed on the stockholders who are qualified to vote in the election of directors in order to ensure the Filipinization of public utilities.⁵⁵ Thus, the Court arrived at its conclusion that “capital” refers to voting stock or shares of stock entitled to vote in the election of directors.⁵⁶ In the present case, “capital” pertained only to common shares because the Articles of Incorporation of PLDT specifically deprived the preferred stockholders of any voting rights.⁵⁷

When the decision was rendered by the Court, various movants⁵⁸ filed a Motion for Reconsideration of the judgment.

B. Dissenting Opinion by Justice Velasco, Jr.

According to Justice Presbitero J. Velasco, Jr., the term “capital” under the Constitution refers to the total outstanding capital stock composed of both voting and non-voting shares.⁵⁹ The salient features of his dissent are as follows.

Firstly, by citing the records of the Constitutional Commission, Justice Velasco, Jr. argued that the phrase “voting stock or controlling interest” was deliberately omitted by the framers.⁶⁰ By using the word “capital” as an alternative, Justice Velasco, Jr. claimed that the Commission contemplated all kinds of shares, whether voting or non-voting.⁶¹

53. *Id.* at 736.

54. *Id.* at 736-37.

55. *Id.* at 737.

56. *See Gamboa*, 652 SCRA at 738.

57. *Gamboa*, 652 SCRA at 737.

58. Among the movants were the Philippine Stock Exchange President, Manuel V. Pangilinan, Napoleon L. Nazareno, and the SEC. *Heirs of Wilson P. Gamboa*, 682 SCRA at 413.

59. *Heirs of Wilson P. Gamboa*, 682 SCRA at 478 (J. Velasco, Jr., dissenting opinion).

60. *See Heirs of Wilson P. Gamboa*, 682 SCRA at 486-98, 518, & 520 (J. Velasco, Jr., dissenting opinion).

61. *Heirs of Wilson P. Gamboa*, 682 SCRA at 520 (J. Velasco, Jr., dissenting opinion).

Secondly, Justice Velasco, Jr. argued that the phrase “entitled to vote” in the FIA should not be limited to common shares alone or those entitled to vote in the election of directors.⁶² Instead, this phrase should also include non-voting shares because these shares are still entitled to vote on fundamental corporate matters as provided by Section 6 of the Corporation Code.⁶³ Although non-voting shares cannot vote in the election of directors, Justice Velasco, Jr. claimed that these shares can still exercise control through their vote in the fundamental corporate matters such as amendment of the Articles of Incorporation.⁶⁴

Thirdly, in a long litany of SEC opinions,⁶⁵ Justice Velasco, Jr. claimed that the SEC has consistently ruled that the total outstanding capital stock consisting of both voting and non-voting shares should be the basis for determining corporate nationality using the control test.⁶⁶ More importantly, by citing another long line of SEC opinions, Justice Velasco, Jr. emphasized that the SEC has already adopted a categorical definition of “capital,” which means total outstanding capital stock composed of both voting and non-voting shares.⁶⁷ He claimed that this definition should be entitled to great respect and weight since it is in accordance with the Constitutional Commission’s intention to use “capital” as applying to all shares, whether voting or non-voting.⁶⁸

Fourthly, Justice Velasco, Jr. interpreted the first portion of the last sentence of Section 11, Article XII of the Constitution as a limitation on the power of foreign stockholders to elect directors.⁶⁹ Specifically, this portion provides that “[t]he participation of foreign investors in the governing body of any public utility enterprise shall be limited to their proportionate share in its capital[.]”⁷⁰ According to Justice Velasco, Jr., foreign stockholders can own more than 40% of the common shares, but their right to vote will only be equivalent to 40% thereof —

In other words, the right of foreign investors to elect the members of the Board of Directors cannot exceed the voting rights of the 40% of the common shares, even though their ownership of common shares may

62. *Id.* at 557.

63. *Id.*

64. *Id.* at 561.

65. *Id.* at 540-43.

66. *Id.* at 543.

67. *Heirs of Wilson P. Gamboa*, 682 SCRA at 543 (J. Velasco, Jr., dissenting opinion).

68. *Id.*

69. *Id.* at 596.

70. PHIL. CONST. art. XII, § 11.

exceed 40%. Thus, since they can only vote up to 40% of the common shares of the corporation, they will never be in a position to elect majority of the members of the Board of Directors. Consequently, control over the membership of the Board of Directors will always be in the hands of Filipino stockholders although they actually own less than 50% of the common shares.⁷¹

This interpretation created a dichotomy between ownership of the voting stock and the right to vote of the shareholder. Specifically, while foreign stockholders can own all of the voting stocks of the corporation, their right to vote will be reduced to merely 40% thereof.⁷² To illustrate, Justice Velasco, Jr. provided the following example —

Let Us apply the foregoing principles to the situation of PLDT. Granting without admitting that foreigners own 64.27% of PLDT's common shares and say they own 40% of the total number of common and preferred shares, still they can only vote up to 40% of the common shares of PLDT since their participation in the election of the Board of Directors (the governing body of the corporation) is limited by the 40% ownership of the capital under the first sentence of [Section] 11, [Article] XII of the Constitution. The foreigners can only elect members of the Board of Directors based on their 40% ownership of the common shares and their directors will only constitute the minority. In no instance can the foreigners obtain the majority seats in the Board of Directors.⁷³

Finally, Justice Velasco, Jr. argued that limiting the definition of “capital” to voting stocks alone would result in the loss of beneficial ownership over the corporation by the Filipinos.⁷⁴ Specifically, he cited an opinion by the SEC,⁷⁵ wherein it was held that the removal of the foreign equity restriction on non-voting shares will altogether result in the acquisition of beneficial ownership over the total outstanding capital stock by the foreigners.⁷⁶ Thus, the Opinion argued that although Filipinos have control over the corporation through their voting shares, effective ownership over the corporate assets still lies with the foreigners.⁷⁷

However, despite the alternative proposal of Justice Velasco, Jr., the Court was not convinced.

71. *Gamboa*, 652 SCRA at 785 (J. Velasco, Jr., separate dissenting opinion).

72. *See Gamboa*, 652 SCRA at 786 (J. Velasco, Jr., separate dissenting opinion).

73. *Gamboa*, 652 SCRA at 785–86 (J. Velasco, Jr., separate dissenting opinion).

74. *Id.* at 788.

75. Securities and Exchange Commission, SEC Opinion Addressed to Mr. George Lavadia, Series of 1995 (Dec. 27, 1995).

76. *See Gamboa*, 652 SCRA at 787–88 (citing SEC Opinion Addressed to Mr. George Lavadia, s. 1995).

77. *Id.* at 788.

C. Analysis: Parameters in Defining Capital

In defining the scope and limitation of “capital” under the Constitution, the Court employed two parameters.

Firstly, the Court used the voting stock or the shares of stock entitled to vote in the election of directors as basis for defining capital because the power to vote in the election of directors is the prime hallmark of corporate control by the stockholder.⁷⁸

Secondly, the Court ruled that mere legal title over the voting stock is insufficient to exercise corporate control.⁷⁹ The stockholder must also have full beneficial ownership over the voting stock.⁸⁰

Relevantly, the separate dissenting opinion written by Justice Velasco, Jr. proposed an alternative parameter — total outstanding capital stock.⁸¹

III. THE RESOLUTION DENYING THE MOTION FOR RECONSIDERATION

Last 9 October 2012, the Supreme Court *En Banc* issued a Resolution denying with finality the Motions for Reconsideration filed in relation to *Gamboa*.⁸² Specifically, the Court affirmed its ruling that the term “capital” in Section 11, Article XII of the Constitution refers only to the voting stock or shares of stock entitled to vote in the election of directors.⁸³ Thereafter, the Court forthwith mandated the SEC to proceed with the application of this judicial definition of capital to determine whether there is a violation of the foreign equity restriction under the Constitution.⁸⁴

A. Overview of the Resolution

Firstly, the Resolution established concrete standards to determine whether a corporation is a Philippine national, to wit — (1) voting control test and (2) beneficial ownership test.⁸⁵ The voting control test uses the voting stock as the yardstick for measuring compliance with nationality requirements.⁸⁶ The Court cited SEC Opinion No. 23-10⁸⁷ as an example of how the voting

78. *Gamboa*, 652 SCRA at 730.

79. *Id.*

80. *Id.*

81. *Gamboa*, 652 SCRA at 777 (J. Velasco, Jr., separate dissenting opinion).

82. *Heirs of Wilson P. Gamboa*, 682 SCRA at 470.

83. *Id.* at 467-68.

84. *Id.* at 467.

85. *Id.* at 424.

86. *Id.* at 418.

87. Securities and Exchange Commission, SEC-OGC Opinion No. 23-10, Series of 2010 (Aug. 18, 2010).

control test was specifically applied by the SEC to determine corporate nationality.⁸⁸ Here, the SEC examined the ownership over the outstanding capital stock entitled to vote.⁸⁹

On the other hand, the beneficial ownership test examines the nature of the ownership over the voting stock.⁹⁰ This test mandates that mere legal title over the voting stock is not enough to comply with nationality requirements.⁹¹ Thus, the Court affirmed its ruling in *Gamboa* that full beneficial ownership is required. According to the Court, this test is codified by Section 1, paragraph (b) of the Implementing Rules of the FIA, which provides that “[f]or 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.”⁹²

Thereafter, the Court proceeded to apply these two standards to define a Philippine national.⁹³ The Court said that this definition is crucial to the case at bar because the FIA implements Section 11, Article XII of the Constitution by providing that only a Philippine national can own and operate a public utility.⁹⁴ According to the Court, both the voting control test and beneficial ownership test are embodied in the statutory definition of a Philippine national as provided by Section 3 (a) of the FIA —

The term ‘Philippine national’ shall mean 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 [] 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 [] 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 [] SEC registered enterprise, at least [] 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 [] 60% of the members of the Board of Directors of both corporations must be citizens of the

88. *Heirs of Wilson P. Gamboa*, 682 SCRA at 418.

89. SEC-OGC Opinion No. 23-10, s. 2010.

90. *Heirs of Wilson P. Gamboa*, 682 SCRA at 442.

91. *Id.* at 443.

92. *Id.* at 442-43 (citing Rules and Regulations Implementing the Foreign Investments Act of 1991, § 1 (b) (3)).

93. *Heirs of Wilson P. Gamboa*, 682 SCRA at 468.

94. *Id.* at 435.

Philippines, in order that the corporations shall be considered a ‘Philippine national.’⁹⁵

In accordance with the voting control test, a corporation is a Philippine national only if at least 60% of its voting stock is owned by Filipino citizens.⁹⁶ Meanwhile, the beneficial ownership test refers to the trustee of funds.⁹⁷ In such case, the trustee must be a Philippine national and at least 60% of the funds will benefit Philippine nationals.⁹⁸ Moreover, the Court emphasized the application of this test by affirming its ruling in the *Gamboa* case that “[f]ull beneficial ownership of 60[%] of the outstanding capital stock, coupled with 60[%] of the voting rights, is required.”⁹⁹

*After establishing the definition of a Philippine national through the use of the voting control and beneficial ownership tests, the Court declared that the 60-40 ownership requirement in favor of Filipino citizens must separately apply to each class of shares, whether common, preferred non-voting, preferred voting, or any other class of shares.*¹⁰⁰ The Court explained that even though preferred shares can be deprived of the right to vote in the election of directors, these shares are still entitled to vote on the following fundamental corporate matters under Section 6 of the Corporation Code: (1) amendment of the Articles of Incorporation; (2) adoption and amendment of by-laws; (3) sale, lease, exchange, mortgage, pledge, or other disposition of all or substantially all of the corporate property; (4) incurring, creating, or increasing bonded indebtedness; (5) increase or decrease of capital stock; (6) merger or consolidation of the corporation with another corporation or other corporations; (7) investment of corporate funds in another corporation or business; and (8) dissolution of the corporation.¹⁰¹

For instance, the Court said that “if a corporation, engaged in a partially nationalized industry, issues a mixture of common and preferred non-voting shares, at least 60[%] of the common shares and at least 60[%] of the preferred non-voting shares must be owned by Filipinos.”¹⁰² The Court opined that this separate application of the foreign equity restriction on each class of shares will ensure Filipinization of public utilities, to wit —

95. *Id.* at 430 (emphasis supplied).

96. *Id.* at 418.

97. *Id.* at 434.

98. *Id.* at 437.

99. *Heirs of Wilson P. Gamboa*, 682 SCRA at 442.

100. *Id.* at 446.

101. *Id.* at 445. See The Corporation Code of the Philippines [CORPORATION CODE], Batas Pambansa Blg. 68, § 6, ¶ 6 (1980).

102. *Heirs of Wilson P. Gamboa*, 682 SCRA at 445.

Applying uniformly the 60-40 ownership requirement in favor of Filipino citizens to each class of shares, regardless of differences in voting rights, privileges[,] and restrictions, guarantees effective Filipino control of public utilities, as mandated by the Constitution.¹⁰³

B. Dissenting Opinion by Justice Velasco, Jr.

Justice Presbitero J. Velasco, Jr. registered a strong dissent to the Resolution by formulating the “three-tiered control-enhancing-and-locking mechanism,” which is found under Section 11, Article XII of the Constitution.¹⁰⁴ This mechanism ensures optimal Filipinization of public utilities by promoting three levels of control over the corporation.¹⁰⁵

The first level of control refers to control over the total outstanding capital stock composed of both voting and non-voting shares.¹⁰⁶ According to Justice Velasco, Jr., control over the outstanding shares is manifested through the determination of fundamental corporate matters laid down in Section 6 of the Corporation Code, wherein non-voting shares are conferred with the right to vote.¹⁰⁷ Moreover, control is also exercised through the inchoate right of the major shareholder to acquire the net assets of the corporation upon its dissolution.¹⁰⁸ Therefore, Justice Velasco, Jr. argues that the definition of “capital” under Section 11, Article XII of the Constitution must refer to the total outstanding capital stock.¹⁰⁹ In this manner, a 40% foreign equity cap on such outstanding shares will be imposed.¹¹⁰

The second level of control refers to control over the voting stock.¹¹¹ According to Justice Velasco, Jr., the first part of the last sentence of Section 11, Article XII of the Constitution imposes a 40% ceiling on the right of foreign stockholders to elect directors. Justice Velasco, Jr. states that “[t]he participation of foreign investors in the governing body of any public utility enterprise shall be limited to their proportionate share in its capital.”¹¹² Accordingly, if the foreign ownership of common shares is less than 40%, the

103. *Id.* at 446.

104. *Heirs of Wilson P. Gamboa*, 682 SCRA at 477 (J. Velasco, Jr., dissenting opinion).

105. *Id.*

106. *Id.* at 473.

107. *Id.* at 474.

108. *Id.*

109. *Id.*

110. *Heirs of Wilson P. Gamboa*, 682 SCRA at 474 (J. Velasco, Jr., dissenting opinion).

111. *Id.* at 475.

112. *Id.* (citing PHIL. CONST. art. XII, § 11).

participation of foreigners is limited to their proportionate share in the total outstanding capital stock.¹¹³

To illustrate, Justice Velasco, Jr. gave the following example —

In the highly hypothetical public utility corporation with 100 common shares and 1,000,000 preferred non-voting shares, or a total of 1,000,100 shares cited in the [28 June] 2011 Decision, foreigners can thus only own up to 400,040 shares of the corporation, consisting of the maximum 40 (out of the 100) voting shares and 400,000 non-voting shares. And, assuming a 10-member board, the foreigners can elect only [four] members of the board using the 40 voting shares they are allowed to own.¹¹⁴

Pertinently, there is a significant change in the interpretation of Justice Velasco, Jr. of the last sentence of Section 11, Article XII of the Constitution. According to his first dissent, foreigners can own more than 40% of the voting stocks, but their right to vote in the election of directors will only be equivalent to 40% thereof.¹¹⁵ On the other hand, in the second dissent, foreigners can only own up to 40% of the voting stocks.¹¹⁶ Concomitantly, their right to vote will be proportional to their ownership of their total shareholdings.

The third level of control refers to the requirement imposed by the last part of the last sentence of Section 11, Article XII of the Constitution — “[A]ll the executive and managing officers of the corporation must be citizens of the Philippines.”¹¹⁷ This Filipinization of corporate officers ensures Filipino control of the corporation regardless of the amount of foreign equity.

C. Analysis: Affirmation of Parameters

The Court affirmed the two parameters used in defining capital by crafting the voting control test and the beneficial ownership test. In accordance with the voting control test, 60% of the voting stocks of a public utility operator must be owned by Filipino citizens.¹¹⁸ Moreover, the beneficial ownership test provides that full beneficial ownership over 60% of these voting stocks must belong to Filipino citizens.¹¹⁹

113. *Heirs of Wilson P. Gamboa*, 682 SCRA at 475 (J. Velasco, Jr., dissenting opinion)

114. *Id.* at 475-76.

115. *Gamboa*, 652 SCRA at 785 (J. Velasco, Jr., separate dissenting opinion) (citing III RECORDS OF THE CONSTITUTIONAL COMMISSION 582).

116. *Heirs of Wilson P. Gamboa*, 682 SCRA at 476 (J. Velasco, Jr., dissenting opinion).

117. *Id.* at 477 (citing PHIL. CONST. art. XII, § 11).

118. *Heirs of Wilson P. Gamboa*, 682 SCRA at 418.

119. *Id.* at 430.

In the second dissenting opinion, Justice Velasco, Jr. affirmed his proposal that “capital” should refer to the total outstanding capital stock by formulating the “three-tiered control-enhancing-and-locking mechanism” under Section 11, Article XII of the Constitution.¹²⁰

D. Supreme Court’s Obiter in Defining Capital

In the Resolution, aside from affirming the two parameters in defining capital, the Court went further and ruled that the 60-40 ownership requirement in favor of Filipino citizens must separately apply to each class of shares, whether common, preferred non-voting, preferred voting, or any other class of shares.¹²¹

It is submitted that this statement by the Court is an *obiter dictum* for the following reasons: firstly, this statement is a significant departure from the “threshold and purely legal issue” of the definition of “capital” under Section 11, Article XII of the Constitution; and secondly, this statement was made by the Court without sufficient explanation or arguments.

IV. REVIEW OF JURISPRUDENCE ON *OBITER DICTUM*

In a long line of cases, the Court has consistently provided the following definition of *obiter dictum* —

An obiter dictum has been defined as an opinion expressed by a court upon some question of law which is not necessary to the decision of the case before it. It is a remark made, or opinion expressed, by a judge, in his decision upon a cause, “by the way,” that is, incidentally or collaterally, and not directly upon the question before him, or upon a point not necessarily involved in the determination of the cause, or introduced by way of illustration, or analogy or argument. Such are not binding as precedent.¹²²

In *People v. Macadaeg*,¹²³ the Court adopted the definition of *obiter dictum* as provided by American jurisprudence — “an opinion ‘uttered by the way, not upon the point or question pending, as if turning aside from the main topic of the case to collateral subjects.’”¹²⁴ The Court also referred to the definition given by Words & Phrases; “[an] opinion [] of a judge which does not embody the resolution or determination of the court, and, [is]

120. *Heirs of Wilson P. Gamboa*, 682 SCRA at 477 (J. Velasco, Jr., dissenting opinion).

121. *Heirs of Wilson P. Gamboa*, 682 SCRA at 446.

122. *Villanueva, Jr. v. Court of Appeals*, 379 SCRA 463, 469 (2002) (citing *Delta Motors Corporation v. Court of Appeals*, 276 SCRA 212, 223 (1997) & *Auyong Hian v. Court of Tax Appeals*, 59 SCRA 110, 120 (1974)).

123. *People v. Macadaeg*, 91 SCRA 410 (1952).

124. *Id.* at 413 (citing *Newman v. Kay*, 49 S.E. 926, 931 (U.S.)).

made without argument or full consideration of the point, and [is] not the professed deliberate determinations of the judge himself[.]”¹²⁵

In *Sta. Lucia Realty v. Cabrigas*,¹²⁶ the Court cited Black’s Law Dictionary, which defined *obiter dictum* as “words of a prior opinion entirely unnecessary for the decision of the case.”¹²⁷ The Court also quoted the definition given by Webster’s Third New International Dictionary — “an incidental and collateral opinion uttered by a judge and therefore not material to his decision or judgment and not binding.”¹²⁸

A careful reading of the above definitions would reveal that there are two standards to determine whether a statement made by the Court is an *obiter dictum*. The first is the materiality or relevancy of the statement to the issue in the case. The second is the presence of arguments to support the statement.

A. Materiality or Relevancy

The statement made by the Court must bear a reasonable connection with the issue raised in the case. Otherwise, the statement will be regarded as an incidental or collateral declaration, which is equivalent to a mere expression of an opinion by the Court. Consequently, such statement has no binding force.

In *City of Manila v. Entote*,¹²⁹ the plaintiff filed a complaint against the defendant to remove a steel fence, which the latter arbitrarily constructed on plaintiff’s land.¹³⁰ The defendant alleged in his answer his right of easement over the plaintiff’s land, which prompted him to construct such fence.¹³¹ The trial court ruled in favor of the plaintiff and ordered the defendant to remove the steel fence.¹³² However, the trial court also went further and declared the existence of a public easement over the plaintiff’s land.¹³³ The Supreme Court ruled that this latter declaration of the trial court is an *obiter dictum* because the existence of a public easement was never an issue in the case.¹³⁴ In his defense, the defendant only alleged his own right of easement

125. *Macadaeg*, 91 SCRA at 413 (citing 29 Words & Phrases 13).

126. *Sta. Lucia Realty and Development, Inc. v. Cabrigas*, 358 SCRA 715 (2001).

127. *Id.* at 725 (citing BLACK’S LAW DICTIONARY 1222 (9th ed. 2009)).

128. *Sta. Lucia Realty and Development, Inc.*, 358 SCRA at 725 (citing WEBSTER’S THIRD NEW INTERNATIONAL DICTIONARY 1555).

129. *City of Manila v. Entote*, 57 SCRA 497 (1974).

130. *Id.* at 507.

131. *Id.*

132. *Id.*

133. *Id.* at 508.

134. *Id.*

over the plaintiff's land.¹³⁵ Therefore, the Court ruled that the unfounded conclusion of the trial court that there is a public easement over the plaintiff's land was a mere expression of an opinion, an *obiter dictum* with no binding force for purposes of *res judicata*.¹³⁶

In *Funa v. Villar*,¹³⁷ the Court referred to *Matibag v. Benipayo*¹³⁸ in order to illustrate an example of an *obiter dictum*.¹³⁹ In *Funa*, the Court ruled that the issues in *Matibag* were specifically defined as follows: (1) nature of an *ad interim* appointment; (2) effect of a by-passed *ad interim* appointment; and (3) renewal of an *ad interim* appointment.¹⁴⁰ However, in the ratio of *Matibag*, the Court extensively discussed the applicability of the Constitutional prohibition on reappointment.¹⁴¹ In *Funa*, the Court declared that the findings of the Court in *Matibag* regarding the constitutional prohibition on reappointment were *obiter dicta*.¹⁴² These were not related to the issues specifically defined by the Court in *Matibag* which revolved around *ad interim* appointments.

On the other hand, in the following cases, the Court found a reasonable connection between the statement alleged as an *obiter dictum* and the issue raised in the case.

In *Macadaeg*, the respondent invoked the decision of the Supreme Court in a previous case to support his petition for amnesty.¹⁴³ Specifically, the respondent alleged that the ruling of the Supreme Court, which disqualified him from entitlement to amnesty was merely an *obiter dictum*.¹⁴⁴ In denying his petition for amnesty, the Court did not consider such ruling as an *obiter dictum*.¹⁴⁵ It was expressly directed towards the resolution of the main issue, which was the applicability of the amnesty proclamation to respondent.¹⁴⁶

In *Villanueva, Jr. v. Court of Appeals*,¹⁴⁷ the main issue was whether the declaration of the appellate court that petitioner Villanueva was not an

135. *City of Manila*, 57 SCRA at 508.

136. *Id.*

137. *Funa v. Villar*, 670 SCRA 579 (2012).

138. *Matibag v. Benipayo*, 380 SCRA 49 (2002).

139. *Funa*, 670 SCRA at 601.

140. *Id.* at 609.

141. *See Matibag*, 380 SCRA at 81-84.

142. *Funa*, 670 SCRA at 610.

143. *Macadaeg*, 91 SCRA at 414.

144. *Id.* at 413.

145. *Id.*

146. *Id.*

147. *Villanueva, Jr.*, 379 SCRA at 463.

offended party in another criminal case was an *obiter dictum*.¹⁴⁸ The Court resolved the issue in the negative and ruled that such statement touched upon a matter clearly raised in the petition for *certiorari* assailing the order of the appellate court.¹⁴⁹

In the same case, the Court also extensively explained the materiality or relevancy rule in determining an *obiter dictum* —

It has been held that an adjudication on any point within the issues presented by the case cannot be considered as *obiter dictum*, and this rule applies to all pertinent questions, although only incidentally involved, which are presented and decided in the regular course of the consideration of the case, and led up to the final conclusion, and to any statement as to matter on which the decision is predicated. Accordingly, a point expressly decided does not lose its value as a precedent because the disposition of the case is, or might have been, made on some other ground, or even though, by reason of other points in the case, the result reached might have been the same if the court had held, on the particular point, otherwise than it did. A decision which the case could have turned on is not regarded as *obiter dictum* merely because, owing to the disposal of the contention, it was necessary to consider another question, nor can an additional reason in a decision, brought forward after the case has been disposed of on one ground, be regarded as *dicta*. So, also, where a case presents two [] or more points, any one of which is sufficient to determine the ultimate issue, but the court actually decides all such points, the case as an authoritative precedent as to every point decided, and none of such points can be regarded as having the status of a *dictum*, and one point should not be denied authority merely because another point was more dwelt on and more fully argued and considered, nor does a decision on one proposition make statements of the court regarding other propositions *dicta*.¹⁵⁰

Thus, insofar as the statement of the Court is relevant in deciding the issue presented in the case, then such statement will not be regarded as an *obiter dictum*.

B. Supporting Arguments

Aside from having a reasonable connection with the issue in the case, the statement of the Court must also be supported by arguments or sufficient explanation.

In *Delta Motors Corporation v. Court of Appeals*,¹⁵¹ the petitioner assailed the amended resolution of the Court of Appeals.¹⁵² This amended resolution

148. *Id.* at 469.

149. *Id.*

150. *Id.* at 469-70 (citing 21 C.J.S. *Dicta* § 190).

151. *Delta Motors Corporation*, 276 SCRA at 212.

152. *Id.* at 215.

deleted a certain paragraph from the previously issued resolution of the Court of Appeals on the ground that such paragraph constituted *obiter dictum*.¹⁵³ In denying the petition, the Court affirmed the Court of Appeals in deleting this paragraph and ruled that “[t]he body of the resolution did not contain any discussion on such matter nor mention any principle of law to support such statement.”¹⁵⁴ Therefore, the Court of Appeals acted correctly in removing the *obiter dictum* in its amended resolution.

In *Land Bank of the Philippines v. Suntay*,¹⁵⁵ respondent invoked a statement of the Court in a previous case to support his Motion for Reconsideration.¹⁵⁶ In denying the Motion, the Court ruled that respondent could not seek relief in such statement because it constituted an *obiter dictum*.¹⁵⁷ It was made without argument or full consideration of the point.

In *Ledesma v. Court of Appeals*,¹⁵⁸ the Court again referred to a previous case, *Tapiador v. Office of the Ombudsman*,¹⁵⁹ in order to illustrate an example of *obiter dictum*. In *Ledesma*, the Court ruled that the statement of the court in *Tapiador*, which described the power of the Ombudsman, was an *obiter dictum*.¹⁶⁰ Specifically, the Court found that this statement was made without sufficient explanation and was therefore susceptible to varying interpretations.¹⁶¹ Moreover, the Court observed that the issue in the case was the failure of the complainant to present substantial evidence.¹⁶²

On the other hand, in the aforementioned *Macadaeg* case, another reason for rejecting the proposition of the applicant for amnesty that the statement of the Court in a previous case was merely an *obiter dictum* was the presence of supporting arguments.¹⁶³ In describing such statement, the Court held that “[i]t was not made without argument or full consideration of the point; it was deliberately entered by the Court after arguments on both sides had been heard. This could not have avoided determining the issue without the peril of rendering an incomplete decision.”¹⁶⁴

153. *Id.*

154. *Id.* at 223.

155. *Land Bank of the Philippines v. Suntay*, 662 SCRA 614 (2011).

156. *Id.* at 627.

157. *Id.* at 646.

158. *Ledesma v. Court of Appeals*, 465 SCRA 437 (2005).

159. *Tapiador v. Office of the Ombudsman*, 379 SCRA 322 (2002).

160. *Ledesma*, 465 SCRA at 449.

161. *Id.*

162. *Id.* 448-49.

163. *Macadaeg*, 91 SCRA at 413.

164. *Id.*

C. Application to the Case at Bar

In view of the aforementioned pronouncements of the Court, it is submitted that the statement of the Court in the Resolution as to the separate application of the foreign equity restriction for each type or class of share should be considered merely as an *obiter dictum*.

Firstly, this statement does not bear a reasonable connection with the issue in the case which is the definition of “capital” under Section 11, Article XII of the Constitution. Particularly, in *Gamboa*, the petitioner initially raised the following issues: (1) whether the sale of the sequestered PTIC shares to FPCL violated the constitutional limit on foreign ownership of a public utility; (2) whether public respondents committed grave abuse of discretion in allowing such sale of shares to FPCL; and (3) whether the sale of common shares to foreigners beyond 40% of the total outstanding capital stock violated the constitutional limit on foreign ownership of a public utility.¹⁶⁵

However, the Court regarded the above issues raised by the petitioner as mere factual questions, which are outside the scope of its jurisdiction.¹⁶⁶ Thus, the Court confined the resolution of the controversy to the “threshold and purely legal issue of whether the term ‘capital’ in Section 11, Article XII of the Constitution refers to the total common shares only or to the total outstanding capital stock (combined total of common and non-voting preferred shares) of PLDT, a public utility.”¹⁶⁷

While the voting control test and beneficial ownership test are parameters used in formulating the constitutional definition of capital, the separate application of the foreign equity restriction is not relevant in understanding the true meaning of “capital” under Section 11, Article XII of the Constitution. The discussion of the Court should revolve around constructing the proper definition of capital instead of probing into the manner of applying the foreign equity restriction. Similar to the cases of *City of Manila* and *Funa*, the statement of the Court as to the separate application of the foreign equity restriction should be considered merely as an incidental or collateral declaration of the Court, which has no relation with the issue of defining capital under the Constitution.

Secondly, the statement was made without argument or full consideration of the relevant points. The Court merely referred to the entitlement of non-voting shares to vote on fundamental corporate matters under Section 6 of the Corporation Code as its springboard for asserting the separate application of the foreign equity restriction. In the cases of *Delta*

165. *Gamboa*, 652 SCRA at 704.

166. *Id.* at 705.

167. *Id.*

Motors Corporation and *Land Bank of the Philippines*, the Court held that a deficiency in explanation would divest a statement of its binding force.¹⁶⁸ In the Resolution, there is a severe lack of explanation on the part of the Court given the legal impact of its statement on the separate application of the foreign equity restriction.

Firstly, this statement will result in a blatant abandonment of the voting control test, which was affirmed by the Court in the same Resolution. Specifically, control can also be exercised by the non-voting shareholders through their vote in the fundamental corporate matters.¹⁶⁹ For this reason, the foreign equity restriction must also apply to them. Ultimately, this statement then proposes that mere ownership of shares of stock regardless of voting capacity shall be the measure of corporate control in direct opposition to the voting control test.

Secondly, this statement also impairs the power of the corporation to classify its own shares of stock. Under Section 6 of the Corporation Code, “[t]he shares of stock of corporation may be divided into classes or series of shares, or both, any of which classes or series of shares may have such rights, privileges, or restrictions as may be stated in the articles of incorporation.”¹⁷⁰ In a SEC Opinion dated 21 September 2006, the SEC General Counsel opined that

[a] corporation may, on its own discretion, for reasons of expediency, for monitoring purposes, or to insure compliance with constitutional or legal requirements, provide for classification of shares. Each class of shares may be assigned varying par values, and likewise, one class of shares may be more than the others.¹⁷¹

In effect, the separate application of the foreign equity restriction prohibits the corporation from issuing a class of shares to be held by foreigners alone.

In view of the radical departure from the voting control test and the undue curtailment of the prerogative of the corporation to classify its shares, it is therefore incumbent upon the Court to provide an explanation to confer binding force on its declaration on the separate application of the foreign equity restriction.

V. RECOMMENDATION ON THE PROPER DEFINITION OF CAPITAL

168. See *Delta Motors Corporation*, 276 SCRA at 223. See also *Land Bank of the Philippines*, 662 SCRA at 648.

169. CORPORATION CODE, § 6.

170. *Id.*

171. Securities and Exchange Commission, SEC Opinion No. 36-06, Series of 2006 (Sep. 21, 2006).

In disregarding the Supreme Court's *obiter dictum* in the Resolution, it is submitted that the proper definition of "capital" should be in accordance with the parameters laid down below.

A. Voting Control Test

"Capital" refers to the voting stock or the shares of stock entitled to vote in the election of directors.¹⁷²

As repeatedly held in the *Gamboa* case, corporate control is wielded by the stockholder primarily through the power to vote in the election of directors.¹⁷³ Pertinently, in *Tan v. Sycip*,¹⁷⁴ the Court elucidated on corporate control by the stockholder —

The right to choose the persons who will direct, manage[,] and operate the corporation is significant, because it is the main way in which a stockholder can have a voice in the management of corporate affairs, or in which a member in a nonstock corporation can have a say on how the purposes and goals of the corporation may be achieved. Once the directors or trustees are elected, the stockholders or members relinquish corporate powers to the board in accordance with law.¹⁷⁵

Thus, the foreign equity restriction must be imposed on these voting stocks in order to ensure that corporate control remains in the hands of Filipino citizens. As explained by Justice Velasco, Jr. in his dissenting opinions, the first part of the last sentence of Section 111, Article XII of the Constitution imposes a 40% ceiling on the right of foreign stockholders to elect directors, namely "[t]he participation of foreign investors in the governing body of any public utility enterprise shall be limited to their proportionate share in its capital."¹⁷⁶

In his first dissenting opinion, Justice Velasco, Jr. opined that the above Constitutional injunction allows foreign ownership of all of the voting stocks but reduces the power to vote of the foreign stockholders to only 40% thereof.¹⁷⁷ On the other hand, in his second dissenting opinion, Justice Velasco, Jr. interpreted the above Constitutional injunction to simply impose

172. *Gamboa*, 652 SCRA at 723.

173. *Id.* at 726.

174. *Tan v. Sycip*, 499 SCRA 216 (2006).

175. *Id.* at 226-27.

176. *Gamboa*, 652 SCRA at 761 (J. Velasco, Jr., separate dissenting opinion) (citing PHIL. CONST. art. XII, § 11).

177. *Gamboa*, 652 SCRA at 785.

a foreign equity restriction of 40% of the voting stocks without reference to the power to vote.¹⁷⁸

The Author agrees with the interpretation of Justice Velasco, Jr. in the second dissenting opinion. In line with the voting control test, foreign ownership of the voting stocks must be limited to only 40%. Thus, foreigners cannot own all of the voting stocks of the corporation while their right to vote in the election of directors is reduced to only 40% thereof. This dichotomy between ownership over the stock and the right to vote cannot be countenanced.

In *Castillo v. Balinghasay*,¹⁷⁹ the Court described the right to vote as an inherent right of the stockholder which cannot be impaired —

One of the rights of a stockholder is the right to participate in the control and management of the corporation that is exercised through his vote. The right to vote is a right inherent in and incidental to the ownership of corporate stock, and as such is a property right. The stockholder cannot be deprived of the right to vote his stock nor may the right be essentially impaired, either by the legislature or by the corporation, without his consent, through amending the charter, or the by-laws.¹⁸⁰

Since “capital” refers to the voting stock or shares of stock entitled to vote in the election of directors, 60% of these voting shares must therefore be reserved for Filipino citizens.

B. Beneficial Ownership Test

“Capital” presupposes that the ownership of Filipino stockholders over the voting stock or shares of stock entitled to vote in the election of directors is full beneficial ownership.

As held in *Gamboa*, mere legal title is not enough to meet the Constitutional requirement.¹⁸¹ As distinguished from legal or naked ownership, Filipinos must have full beneficial ownership over the voting stocks.¹⁸²

In a SEC Opinion dated 17 May 1990, the SEC Chairman explained the rationale behind the beneficial ownership test —

178. *Heirs of Wilson P. Gamboa*, 682 SCRA at 476 (J. Velasco, Jr., dissenting opinion).

179. *Castillo v. Balinghasay*, 440 SCRA 442 (2004).

180. *Id.* at 453 (citing WILLIAM MEADE FLETCHER, *FLETCHER CYCLOPEDIA OF THE LAW OF PRIVATE CORPORATIONS* 116 (1976)).

181. *Gamboa*, 652 SCRA at 730.

182. *Id.*

While under the Corporation Code, there is no general requirement of Philippine citizenship, there are some areas of business and industry where ownership is reserved, wholly or partially, in favor of Filipino citizens by virtue of the Constitution and various special laws. Even if the constitutional or statutory provisions refer merely to ownership of stock in the corporation, the nationality requirement is not satisfied unless it meets the criteria of beneficial ownership and power control over corporations intended solely for Filipinos.

To construe the equity requirement as merely limiting ownership in the capital without limiting the controlling interest may give rise to a dangerous situation where although the ownership in capital belongs to Filipinos, the management [or] control of the company would be absolutely under alien control. Such a situation would only be a pro-forma compliance with the equity rule and does not serve the very purpose of the Constitutional and statutory mandates giving the Filipinos the power to control certain areas of business activities. Any scheme or arrangement which attempts to defeat the Constitutional and statutory mandates on equity participation, should not be allowed.¹⁸³

In another SEC Opinion dated 28 November 2007, the SEC General Counsel affirmed the significance of beneficial ownership in relation to corporate control by the stockholders —

It would not be amiss, however, to state at this point that the purpose of the [] 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.¹⁸⁴

Meanwhile, in a Department of Justice (DOJ) Opinion dated 3 May 1989, it was argued that the primordial consideration in the application of the beneficial ownership test is the *situs* of control by the stockholders —

This Department has had occasion to rule in several opinions that it is implicit in the [C]onstitutional provisions reserving the exploitation, development[,] and utilization of natural resources to citizens of the Philippines or to corporations or associations at least 60% of the capital of which is owned by citizens of the Philippines, that *the nationality requirement, in case of a corporation, is not satisfied unless it meets the criterion of beneficial ownership, i.e., that Filipinos are the principal beneficiaries in the exploration of natural resources and that in applying the same ‘the primordial*

183. Securities and Exchange Commission, SEC Opinion Addressed to Mr. Mariano Sarmiento II, Series of 1990 (May 17, 1990).

184. Securities and Exchange Commission, SEC-OGC Opinion No. 20-07, Series of 2007 (Nov. 28, 2007).

consideration is situs of control, whether in a stock or non-stock corporation.’ As stated in Register of Deeds [v.] Ung Siu Si Temple, the purpose of the [60%] requirement is obviously to ensure that corporations and associations allowed to acquire agricultural land or to exploit natural resources shall be controlled by Filipinos.¹⁸⁵

Thus, the purpose of the beneficial ownership test is to avoid the circumvention of the foreign equity restriction through simulated ownerships. For example, the legal title of the shares is registered in the name of Filipino stockholders. However, in reality, these Filipino stockholders merely serve as trustees who hold the shares in trust for the benefit of foreign nationals. In this case, the Filipino stockholders do not have full beneficial ownership over the shares of stock because they are unable to exercise their voting and investment power.

In this light, the imposition of the foreign equity restriction must strictly require the simultaneous application of the beneficial ownership test in order to avoid the wanton evasion of the law on nationalized or partly nationalized activities. Since the foreign equity restriction is enforced on the voting stock by reason of the voting control test, then the beneficial ownership test must also be applied to the same.

Relevantly, beneficial ownership is defined under the Amended Implementing Rules and Regulations of the Securities and Regulation Code, thus —

Beneficial owner or beneficial ownership means any person who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise has or shares: voting power, which includes the power to vote, or to direct the voting of, such security; and/or investment returns or power, which includes the power to dispose of, or to direct, the disposition of such security; *provided, however,* that a person shall be deemed to have an indirect beneficial ownership interest in any security which is:

- (i) held by members of his immediate family sharing the same household;
- (ii) held by a partnership in which he is a general partner;
- (iii) held by a corporation of which he is a controlling shareholder; or
- (iv) subject to any contract, arrangement[,] or understanding which gives him voting power or investment power with respect to such securities: *provided, however,* the following persons or institutions shall not be deemed to be beneficial owners of securities held by them for the benefit of third parties or in customer or fiduciary accounts in the ordinary course of business, so long as such shares were acquired by such persons or institutions without the purpose or effect of changing or influencing control of the issuer:
 - (a) A broker dealer;

185. Department of Justice, DOJ Opinion No. 093, Series of 1989 (May 3, 1989) (emphases supplied).

- (b) An investment house registered under the Investment Houses Law;
- (c) A bank authorized to operate as such by the Bangko Sentral ng Pilipinas;
- (d) An insurance company subject to the supervision of the Office of the Insurance Commission;
- (e) An investment company registered under the Investment Company Act;
- (f) A pension plan subject to regulation and supervision by the Bureau of Internal Revenue and/or the Office of the Insurance Commission; and
- (g) A group in which all of the members are persons specified above.

All securities of the same class beneficially owned by a person, regardless of the form such beneficial ownership takes, shall be aggregated in calculating the number of shares beneficially owned by such person.

A person shall be deemed to be the beneficial owner of a security if that person has the right to acquire beneficial ownership within [] 30 days, including, but not limited to, any right to acquire; through the exercise of any option, warrant[,] or right; through the conversion of any security; pursuant to the power to revoke a trust, discretionary account[,] or similar arrangement; or pursuant to automatic termination of a trust, discretionary account[,] or similar arrangement.¹⁸⁶

It can be gleaned from the above Provision that in order to have full beneficial ownership over the shares of stock, the voting and investment power must ultimately remain with the stockholder. Thus, in order to pass the beneficial ownership test vis-à-vis the voting control test, it is submitted that the Filipino stockholders must exercise the voting and investment power over the voting stocks of the corporation.

C. Total Outstanding Capital Stock

“Capital” refers to the total outstanding capital stock composed of both voting and non-voting shares of the corporation.

It is submitted that the foreign equity restriction must be imposed not only on the voting stock, but also on the total outstanding capital stock of the corporation.

In the two dissenting opinions of Justice Velasco, Jr., he argued that the foreign equity restriction must be imposed on the total outstanding capital

186. Amended Rules and Regulations Implementing the Securities Regulation Code, Republic Act No. 7899, rule 3 (1) (a) (2000).

stock of the corporation.¹⁸⁷ For this reason, he applied the beneficial ownership test over the same.¹⁸⁸ Specifically, he argued that the loss of beneficial ownership by the Filipino stockholders over the total outstanding capital stock will have two profound effects — forfeiture of effective ownership over the corporate assets and loss of ultimate control in the fundamental corporate matters under Section 6 of the Corporation Code.¹⁸⁹

In the first dissenting opinion, Justice Velasco, Jr. explained the manner by which Filipino stockholders will be deprived of effective ownership over the corporate assets if there is no beneficial ownership over the total outstanding capital stock. To illustrate, he cited a paragraph from a SEC Opinion addressed to Mr. George Lavadia —

To construe the 60-40% equity requirement is merely based on the voting shares, disregarding the preferred non-voting shares, not on the total outstanding subscribed capital stock, would give rise to a situation where the actual foreign interest would not really be only 40% but may extend beyond that because they could also own even the entire preferred non-voting shares. In this situation, Filipinos may have the control in the operation of the corporation by way of voting rights, but have no effective ownership of the corporate assets which include lands, because the actual Filipino equity constitutes only a minority of the entire outstanding capital stock. Therefore, in essence, the company, although controlled by Filipinos, is beneficially owned by foreigners since the actual ownership of at least 60% of the entire outstanding capital stocks would be in the hands of foreigners. Allowing this situation would open the floodgates to circumvention of the intent of the law to make the Filipinos the principal beneficiaries in the ownership of Philippine alienable lands.¹⁹⁰

On the other hand, in the second dissenting opinion, Justice Velasco, Jr. concretely described how the Filipino stockholders will lose control over the fundamental corporate matters under Section 6 of the Corporation Code if there is no beneficial ownership over the total outstanding capital stock. Thus, he provided a hypothetical scenario involving a public utility with 100 voting shares and 1,000,000 non-voting shares —

For instance, let us suppose that the authorized capital stock of a public utility corporation is divided into 100 common shares and 1,000,000 non-voting preferred shares. Since, according to the Court's [28 June 2011] Decision, the word 'capital' in [Section] 11, [Article] XII refers only to the

187. *See Gamboa*, 652 SCRA at 762 (J. Velasco, Jr., separate dissenting opinion). *See also Heirs of Wilson P. Gamboa*, 682 SCRA at 536 (J. Velasco, Jr., dissenting opinion).

188. *Id.*

189. *Heirs of Wilson P. Gamboa*, 682 SCRA at 532 (J. Velasco, Jr., dissenting opinion).

190. *Gamboa*, 652 SCRA at 788 (J. Velasco, separate dissenting opinion).

voting shares, then the 40% cap on foreign ownership applies only to the 100 common shares. Foreigners can, therefore, own 100% of the 1,000,000 nonvoting preferred shares. But then again, the *ponencia* continues, at least, the ‘control’ rests with the Filipinos because the 60% Filipino-owned common shares will necessarily ordain the majority in the governing body of the public utility corporation, the board of directors[, or] trustees. Hence, Filipinos are assured of control over the day-to-day activities of the public utility corporation.

Let us, however, take this corporate scenario a little bit farther and consider the irresistible implications of changes and circumstances that are inevitable and common in the business world. Consider the simple matter of a possible investment of corporate funds in another corporation or business, or a merger of the public utility corporation, or a possible dissolution of the public utility corporation. *Who has the ‘control’ over these vital and important corporate matters?* The last paragraph of [Section] 6 of the Corporation Code provides —

Where the articles of incorporation provide for non-voting shares in the cases allowed by this Code, the holders of such (non-voting) shares shall nevertheless be entitled to vote on the following matters:

- (1) Amendment of the articles of incorporation;
- (2) Adoption and amendment of by-laws;
- (3) Sale, lease, exchange, mortgage, pledge or other disposition of all or substantially all of the corporate property;
- (4) Incurring, creating or increasing bonded indebtedness;
- (5) Increase or decrease of capital stock;
- (6) Merger or consolidation of the corporation with another corporation or other corporations;
- (7) Investment of corporate funds in another corporation or business in accordance with this Code; and
- (8) Dissolution of the corporation.

In our hypothetical case, all 1,000,100 (voting and non-voting) shares are entitled to vote in cases involving fundamental and major changes in the corporate structure, such as those listed in [Section] 6 of the Corporation Code. Hence, with only 60 out of the 1,000,100 shares in the hands of the Filipino shareholders, control is definitely in the hands of the foreigners. The foreigners can opt to invest in other businesses and corporations, increase its bonded indebtedness, and even dissolve the public utility corporation against the interest of the Filipino holders of the majority voting shares. This cannot plausibly be the constitutional intent.¹⁹¹

191. *Heirs of Wilson P. Gamboa*, 682 SCRA at 545-47 (J. Velasco, Jr., dissenting opinion) (citing CORPORATION CODE, § 6).

The Author agrees with the position taken by Justice Velasco, Jr. that both the foreign equity restriction and the concomitant beneficial ownership test must be applied not only to the voting stock, but also to the total outstanding capital stock of the corporation.

Firstly, this is required in order to preserve the effective ownership of Filipino stockholders over the corporate assets.

One of the rights of the stockholder is the right to a proportionate share of the remaining assets of the corporation upon dissolution and liquidation. Section 122 of the Corporation Code provides that “[e]xcept by decrease of capital stock and as otherwise allowed by [the Corporation] Code, no corporation shall distribute any of its assets or property except upon lawful dissolution and after payment of all its debts and liabilities.”¹⁹² The procedure for corporate liquidation must be in accordance with the *Trust Fund Doctrine*, which mandates that the debts and liabilities of the dissolved corporation to its creditors must first be satisfied prior to the distribution of the net corporate assets to the stockholders.¹⁹³ Thereafter, in the absence of any provision to the contrary, the net corporate assets are to be distributed among the stockholders in proportion to their shareholdings.¹⁹⁴ Relevantly, preferred non-voting shares can be prioritized in the distribution of net corporate assets upon liquidation.¹⁹⁵

In view of the above, if the Filipino stockholders do not have beneficial ownership over the total outstanding capital stock, then majority of the net corporate assets will go to the hands of the foreign stockholders. Moreover, if these corporate assets involve private lands, then there will be an outright violation of the Constitutional mandate that only Filipinos can own such private lands.¹⁹⁶

Secondly, the foreign equity restriction and the beneficial ownership test must be applied to the total outstanding capital stock of the corporation in order to achieve control over the fundamental corporate matters under Section 6 of the Corporation Code in favor of the Filipino stockholders. Otherwise, if only the voting control test were to be sustained, then the Filipino stockholders will relinquish command over such matters laid down in Section 6.

192. CORPORATION CODE, § 122, ¶ 4.

193. *Ong Yong v. Tiu*, 401 SCRA 1, 18 (2003).

194. *See* *Stockholders of F. Guanzon & Sons, Inc. v. Register of Deeds of Manila*, 6 SCRA 373 (1962).

195. *See* *Republic Planters Bank v. Agana, Sr.*, 269 SCRA 1 (1997).

196. *See* *Heirs of Wilson P. Gamboa*, 682 SCRA at 544 (J. Velasco, Jr., dissenting opinion).

Therefore, in order to achieve beneficial ownership over the total outstanding capital stock, “capital” must refer to the total outstanding capital stock.

D. Tri-Level Application of the Foreign Equity Restriction

The above parameters in defining “capital” will ultimately result in the tri-level application of the foreign equity restriction in determining compliance with laws on partly nationalized activities.

Firstly, in accordance with the voting control test, the foreign equity restriction must be applied to the voting stock or shares of stock entitled to vote in the election of directors.¹⁹⁷

Secondly, in accordance with the beneficial ownership test, there must be full beneficial ownership over the above voting stock in favor of Filipino stockholders.¹⁹⁸ Full beneficial ownership requires the absolute exercise of voting and investment power.

Finally, the foreign equity restriction must also be applied to the total outstanding capital stock composed of both voting and non-voting shares.¹⁹⁹ Similarly, full beneficial ownership over the same in favor of Filipino stockholders is required.

In the case at bar, the tri-level application of the foreign equity restriction will proceed in the manner laid down below.

Firstly, at least 60% of the voting stocks of the public utility must be held by Filipino stockholders.

Secondly, the ownership of the Filipino stockholders over these voting stocks must refer to full beneficial ownership. This means that they have the capacity to exercise the voting and investment power over these voting stocks.

Finally, at least 60% of the total outstanding capital stock composed of both voting and non-voting shares of the public utility must be held by Filipino stockholders. Concomitantly, ownership over the same must also refer to full beneficial ownership which involves possession of voting and investment power.

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197. *Gamboa*, 652 SCRA at 723.

198. *Id.* at 730.

199. *Heirs of Wilson P. Gamboa*, 682 SCRA at 543 (J. Velasco, Jr., dissenting opinion).

Last 20 May 2013, the SEC issued Memorandum Circular No. 8 entitled Guidelines on Compliance with the Filipino-Foreign Ownership Requirements Prescribed in the Constitution and/or Existing Laws by Corporations Engaged in Nationalized and Partly Nationalized Activities (“Guidelines”).²⁰⁰ The Guidelines provides a regulatory framework for the implementation of the *Gamboa* case which defined “capital” in Section 11, Article XII of the 1987 Constitution as shares of stock entitled to vote in the election of directors.

Relevantly, the Guidelines is a significant departure from the initial proposed regulation of the SEC to implement the *Gamboa* case (“Draft Circular”). Entitled as Guidelines, Rules and Regulations on Registration, Monitoring & Investigation of Compliance by Corporations Engaged in Nationalized or Partly Nationalized Activities with Ownership Requirements in the Constitution and/or Existing Laws, and Imposing Penalties for Violations Thereof, the Draft Circular was issued by the SEC last 8 November 2012 in order to solicit comments from the public legal sector.²⁰¹ One of the highlights of the Draft Circular is the requirement that a corporation must “at all times, observe the constitutional or statutory ownership restrictions for each class of shares; Provided that, if any class of shares is divided into series of shares and a particular series of shares has different rights, privileges, and limitations, the [corporation] must observe the same ownership restriction for said series of shares.”²⁰² This means that the foreign equity restriction must be separately applied for each class of shares, whether common, preferred non-voting, preferred voting, or any other class of shares.

This separate application of the foreign equity restriction for each class of shares has been removed by the Guidelines. In its place, the Guidelines adopted a different method of applying the foreign equity restriction by referring to the voting stock or shares of stock entitled to vote in the election of directors, and the total outstanding capital stock composed of both voting and non-voting shares.

Thus, Section 2 of the Guidelines provides for the following —

200. Securities and Exchange Commission, Guidelines on Compliance with the Filipino-Foreign Ownership Requirements Prescribed in the Constitution and/or Existing Laws by Corporations Engaged in Nationalized and Partly Nationalized Activities, SEC Memorandum Circular No. 8, Series of 2013 [SEC Memo. Circ. No. 8, s. 2013] (May 22, 2013).

201. Securities and Exchange Commission, Guidelines on Compliance with the Filipino-Foreign Ownership Requirements Prescribed in the Constitution and/or Existing Laws by Corporations Engaged in Nationalized and Partly Nationalized Activities, Draft Memorandum Circular (Nov. 8, 2012).

202. *Id.* § 4.

All covered corporations shall, at all times, observe the constitutional or statutory ownership requirement. For purposes of determining compliance therewith, the required percentage of Filipino ownership shall be applied to BOTH (a) the total number of outstanding shares of stock entitled to vote in the election of directors; AND (b) the total number of outstanding shares of stock, whether or not entitled to vote in the election of directors.

Corporations covered by special laws which provide specific citizenship requirements shall comply with the provisions of said law.²⁰³

Clearly, in defining “capital” under the Constitution, the Guidelines employs the Voting Control Test and the Total Outstanding Capital Stock as parameters.

On the other hand, the Beneficial Ownership Test is reflected in the following introductory clauses of the Guidelines —

WHEREAS, Section 1 (b) of the IRR of FIA clearly requires the existence of full beneficial ownership of the stocks and appropriate voting rights in determining whether stocks are owned and held by Philippine nationals;

WHEREAS, it is essential to ensure that full beneficial ownership and effective control of the appropriate voting rights lie with Philippine nationals.²⁰⁴

It is therefore recommended that the Beneficial Ownership Test under the Guidelines be expanded to include the argument of Justice Velasco that full beneficial ownership over the total outstanding capital stock in favor of Filipino citizens is also required. In order to avoid the circumvention of the law on nationalized or partly nationalized activities, the application of the foreign equity restriction must be coupled with the Beneficial Ownership Test. Thus, if the foreign equity restriction is to be imposed on the total outstanding capital stock, then the Beneficial Ownership Test must also be applied to the same.

Since the foreign equity restrictions are now imposed not only on the voting stock of covered corporations, but also on the total outstanding capital stock composed of both voting and non-voting shares, foreign investors may need to review the structure of their equity investments in the Philippines. Meanwhile, those corporations which are not yet compliant with the foreign equity restrictions under the Guidelines are enjoined to implement the necessary changes to their capital structure until 22 May 2014.²⁰⁵

203. SEC Memo. Circ. No. 8, s. 2013, § 2.

204. *Id.* whereas cl.

205. *Id.* § 2.