Foreign Investment Law: Studying the Administrative Treatment of Legislative Restrictions

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I. INTRODUCTION

Restricting foreign ownership of corporations that engage in capital intensive enterprises such as the exploration, development, and utilization of natural resources and in the infrastructure-building and development of public utilities, seems to have no place in a developing country like the Philippines. It is in these industries where there exists a great need for foreign capital as local capital is either insufficient or unwilling to invest. Foreign ownership of corporations engaged in the development of natural resources and the operation of public utilities, however, is limited by law. That these

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limitations are embodied in the Constitution (and the amendment of which would require a cumbersome and lengthy process) reflect the Filipino's reluctance to introduce foreign capital in these areas of the economy. The deliberations of the constitutional commissioners in the drafting of the 1987 Constitution reveal the philosophical underpinnings of the limitations on foreign participation — that natural resources are exclusive gifts from God which must be reserved for Filipino citizens,[1] that Filipinos should retain control over important industries that greatly matter in their daily lives,[2] and that reliance on foreign capital would undermine national security and economic sovereignty.[3]

However, even if the Constitution has limited foreign investment to certain thresholds, its implementing laws, as well as the application by administrative agencies, primarily the Securities and Exchange Commission (SEC), appear to provide a counter-balance mechanism to the restrictive rules on the entry of foreign capital. Various means have been sanctioned through which foreign partners of local enterprises may enjoy protection and in the process enjoy a limited degree of control, without their ownership in the company going beyond the requirements under each particular law.

Administrative agencies are the government's frontline in regulating the flow of foreign investments into the Philippines. While their mandate is enshrined in the Constitution and in statute, they are given great discretion within which to exercise this mandate. The mechanisms that have been sanctioned in order to allow foreigners some control over their investments thus arise on an *ad hoc* basis, without the benefit of the deliberative process of congressional body that allows the adoption of a consistent philosophy integrated in national issues and without a mechanism for refining issuances to make them consistent.

While the lack of this deliberative process may be a hindrance to the adoption of a consistent policy, this ability of administrative institutions to act without a lengthy and cumbersome deliberative process, and the institution's relative political independence, may be the key to the rationalization of foreign investment policy, given the state of the law. The strength of administrative action thus merits examination in order to determine whether there is a stable legal environment for the continued enforcement of these mechanisms that allow for limited foreign control over

1. II Journal of the Constitutional Commission 782-83 (1986) [hereinafter II Journal].
2. *Id.* at 656-57.
3. *Id.* at 650-51.

their investments, beyond what is expressly provided for in the Constitution and statute.

This paper examines the question of how administrative agencies, particularly the SEC, has interpreted the issue of nationality of corporations. It also looks into the persuasive, if not binding, force of such interpretation. The first section examines the means that have thus far been sanctioned through which foreign investors have been able to gain control over their investments in corporations — means not expressly provided for in nationality laws. The second section of the paper examines the consistency of these means. The third section analyzes the character of administrative agencies vis-à-vis the role they have taken, in an effort to determine whether the grant of such role to administrative agencies without a re-orientation of law, gives the Philippines a stable legal environment where investors can make a rational decision to invest.

II. FOREIGN CONTROL OVER INVESTMENTS VEHICLES

Given the great debate on whether foreign capital may invest in traditionally nationalized activities, Philippine law has yet to provide a direct means of determining the nationality of a corporation. The means by which this is provided is through the definition of a *foreign corporation* under the Corporation Code.[4] Section 123 thereof provides: "[a] foreign corporation is one formed, organized or existing under any laws other than those of the Philippines and whose laws allow Filipino citizens and corporations to do business in its own country or state."[5]

Under this definition, a corporation is *foreign* if (a) it is formed, organized or existing under any laws other than those of the Philippines, and (b) the law of the state under which it was organized allows Filipino citizens and corporations to do business in that state. This definition of a foreign corporation does not even take into consideration the Filipino ownership or control of such corporation formed under the law of a foreign state. Under this test, ownership or control of the corporation has no place in the determination of the nationality of the corporation and the primary test of nationality is the determination of the applicable law under which the corporation was incorporated. Since the applicable law is usually based on the place where the incorporation is done, the law of incorporation is also

4. The Corporation Code of the Philippines [CORPORATION CODE], Batas Pambansa Blg. 68, § 6 (1980).

5. *Id.* § 123.

the place of incorporation. This test is called the *place of incorporation test*. As confirmed by the SEC in a recent opinion:

> Under Philippine jurisdiction, the primary test is always the Place of Incorporation Test, since we adhere to the doctrine that a corporation is a creature of the State under whose laws it has been created. A corporation organized under the laws of a foreign country, irrespective of the nationality of the persons who control it, is necessarily a foreign corporation.[6]

Ownership of the corporation comes in only when the corporation now desires to undertake certain activities such as developing natural resources or operating public utilities. Only if a certain threshold of Filipino ownership is met may the corporation engage in these activities.

This test, where the citizenship of the controlling stockholders determines the nationality of the corporation is called the *control test*. It is not the *ownership test* because the spirit of requiring certain ownership thresholds is to enable majority owner to also hold control. Otherwise, if ownership were the primordial consideration, then it would only be a simple matter of separating legal title from beneficial title.

The law which seeks to define Philippine law on foreign investment is the Foreign Investments Act (FIA).[7] The FIA provides that foreigners may invest in any venture in the Philippines for up to 100 percent, except for those activities provided for in the Negative List. The Negative List, which is updated every two years, sets out the definitive listing of activities where foreign participation is limited to Philippine nationals.

FIA defines a Philippine national to mean:

> a. a corporation organized under the laws of the Philippines of which at least sixty percent (60 percent) of the capital stock outstanding and entitled to vote is owned and held by citizens of the Philippines; or
>
> b. a corporation organized abroad and registered as doing business in the Philippines under the Corporation Code of which one hundred percent (100 percent) of the capital stock outstanding and entitled to vote is wholly owned by Filipinos; or
>
> c. a trustee of funds for pension or other employee retirement or separation benefits, where the trustee is a Philippine national and at least sixty

6. SEC Opinion No. 14-04, Mar. 3, 2004. Opinion of Vernette G. Umali-Paco, addressed to Tan & Concepcion Law Firm.

7. Foreign Investments Act of 1991 [FIA], Republic Act No. 7042, as amended by Republic Act No. 8179 (1991).

> percent (60 percent) of the fund will accrue to the benefit of 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 percent) of the capital stock outstanding and entitled to vote of each of both corporations must be owned and held by citizens of the Philippines and at least sixty percent (60 percent) of the members of the Board of Directors, in order that the corporation shall be considered a Philippine national.[8]

Even beyond their allowable equity participation, certain mechanisms have been adopted by foreign investors in order to gain more control apart from the relatively smaller shareholdings that they have in the vehicle where they have invested, considering that they may indeed be providing the entire financial and technological support for the enterprises in which they invest.

A. Minority Protection

The Philippine national under the FIA allowed the undertaking of the activity in the Negative List that will have a Philippine and a foreign component. For a mining company developing minerals under a mineral production and sharing agreement for instance, the Philippine component will be 60 percent and the foreign component will be 40 percent.[9] This is because of the *control test* – the mining company must be under the effective control of Filipino stockholders. This means that apart from decisions which require an approval from shareholders holding two-thirds (or 66.66 percent) of the capital stock to agree, what the Filipino shareholders desire, prevails.

However, these are default rules and may be modified by the parties' agreement. Typically, this would include the setting of quorum and voting requirements to be higher than those provided for in the Corporation Code. The approval of certain corporate acts by the Board of Directors such as (i) a sale of properties owned by the company, (ii) an amendment of the Articles of Incorporation and By-laws of the company, or (iii) an increase or decrease in the company's capital stock, may be subjected to a high vote requirement. For instance, two-thirds vote instead of the usual majority vote. Corporate acts that require stockholders' approval may also be subjected to a similar high vote requirement.

B. Ownership of Philippine component of the Philippine national

8. *Id.* § 3.
9. PHIL. CONST. art XII, § 2.

Another means that has been utilized in order to provide the foreign shareholder more control in the corporation is to have the foreign shareholder own stock in the Filipino component of the investment vehicle. Under this set-up, while the company engaging in mining or telecommunications might only have 40 percent foreign shareholdings, by owning a portion of the Filipino corporate shareholder, such foreign shareholder can then influence the *Filipino* shareholder vote.

Early on, the SEC has recognized the possible circumvention of the *control test*. If the Filipino corporate shareholder of a company engaged in a nationalized activity is entirely held by the foreign corporate shareholder, the *control test* would have been an empty pronouncement. Thus, the 1967 SEC Rules[10] extends the test of control to the owner of the Filipino corporation. This rule, which was eventually called the *grandfather test*, was enunciated in this manner:

> Shares belonging to corporations or partnerships at least 60 percent of the capital of which is owned by Filipino citizens shall be considered as of Philippine nationality, but *if the percentage of Filipino ownership in the corporation or partnership is less than 60 percent, only the number of shares corresponding to such percentage shall be counted as of Philippine nationality.*[11]

The Department of Justice (DOJ) explains the rule, to wit:

> Under the above-quoted SEC Rules, there are two cases in determining the nationality of the Investee Corporation. The first case is the *liberal rule*, later coined by the SEC as the *control test* in its 30 May 1990 Opinion, and pertains to the portion in said Paragraph 7 of the 1967 SEC Rules which states, "(s)hares belonging to corporations or partnerships at least 60 percent of the capital of which is owned by Filipino citizens shall be considered as of Philippine nationality." Under the liberal Control Test, there is no need to further trace the ownership of the 60 percent (or more) Filipino stockholdings of the Investing Corporation since a corporation which is at least 60 percent Filipino-owned is considered as Filipino.
>
> The second case is the *strict rule* or the *grandfather rule proper* and pertains to the portion in said Paragraph 7 of the 1967 SEC Rules which states, "but if the percentage of Filipino ownership in the corporation or partnership is less than 60 percent, only the number of shares corresponding to such percentage shall be counted as of Philippine nationality." Under the Strict Rule or Grandfather Rule Proper, the combined totals in the Investing Corporation and the Investee Corporation must be traced (i.e., "grandfathered") to determine the total percentage of Filipino ownership.

10. SEC Rules, ¶ 7 (1967).
11. *Id.* (emphasis supplied).

Moreover, the ultimate Filipino ownership of the shares must first be traced to the level of the Investing Corporation and added to the shares directly owned in the Investee Corporation.[12]

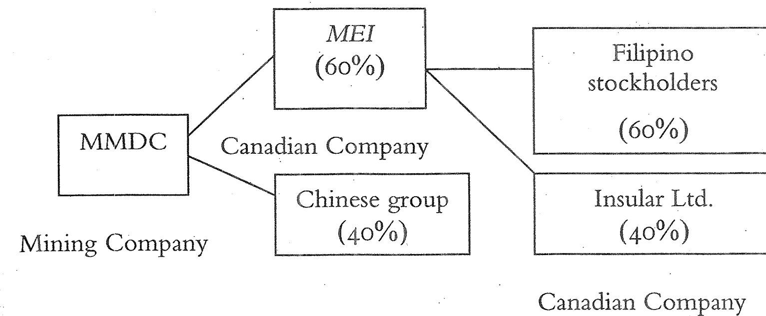
Illustrating paragraph 7 of the 1967 SEC Rule, this Department went further, to wit:

> Thus, if 100,000 shares are registered in the name of a corporation or partnership at least 60 percent of the capital stock or capital respectively, of which belong to Filipino citizens, all of the said shares shall be recorded as owned by Filipinos. But if less than 60 percent, or say, only 50 percent 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.
>
> In other words, based on the said SEC Rule and DOJ Opinion, the Grandfather Rule or the second part of the SEC Rule applies only when the 60-40 Filipino-foreign equity ownership is in doubt (i.e. in cases where the joint venture corporation with Filipino and foreign stockholders with less than 60 percent Filipino stockholdings [or 59 percent] invests in another joint venture corporation which is either 60-40 percent Filipino-alien or 59 percent less Filipino. Stated differently, where the 60-40 Filipino-foreign equity ownership is not in doubt, the Grandfather Rule will not apply.[13]

The DOJ has opined that the grandfather rule continues to subsist and has not been abandoned.[14] The SEC's position, on the other hand, has been ambiguous. In a 1993 opinion, the SEC has opined based on the control test, and has held that a corporation which has the following corporate structure is qualified to engage in mining activities in the Philippines.[15]

12. DOJ Opinion No. 020, s. 2005.
13. *Id.*
14. *Id. See also* SEC Opinion No. 64-03, Nov. 27, 2003, by Vernette G. Umali-Paco, General Counsel to Atty. Jose Oscar M. Salazar.
15. SEC Opinion, Mar. 23, 1993, by Rosario N. Lopez, Chairman, to Mr. Francis F. How.

ILLUSTRATION 1



Under the structure, *MEI* was considered a Philippine national because 60 percent of its stocks were owned by Filipino stockholders. Hence, all of its stocks were considered Filipino. The SEC explained:

> In determining the nationality of corporations with foreign equity, the Commission En Banc, on the basis of the opinion of the Department of Justice No. 18, s. 1989, dated 19 January 1989, voted and decided to do away with the strict application/computation of the so called *grandfather rule*, and instead applied the so called *control test* method of determining corporate nationality. The method as applied in the said case states as follows:
>
> Shares belonging to corporations or partnerships at least 60 percent of the capital of which is owned by Filipino citizens shall be considered as of Philippine nationality, but if the percentage of Filipino ownership in the corporation or partnership, is less than 60 percent, 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 percent 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 percent, or say only 50 percent 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.
>
> Applying the above-ruling to the instant case, MEI, which is 60 percent Filipino owned, is considered a Filipino company. Consequently, its investment in MMDC is considered that of a Filipino. Therefore, the 60

percent Filipino equity requirement for mining companies would still be met by MMDC.[16]

The opinion, went on to say that: "[a]ccordingly, MMDC may be qualified to engage in mining activities, provided that *the voting and Board membership requirements* under Section 3 of R.A. 7042, otherwise known as the Foreign Investments Act of 1991, quoted hereunder, are complied with."[17]

Section 3 of R.A. 7042 requires that where a corporation and its non-Filipino stockholders own stocks in an SEC registered enterprise, in order that the corporation shall be considered a Philippine national, the following requisites must be complied with:

1. At least 60 percent of the capital stocks outstanding and entitled to vote of both corporations must be owned and held by citizens of the Philippines, and
2. At least 60 percent of the members of the Board of Directors of both corporations must be citizens of the Philippines[18]

Note that the opinion states that the SEC has voted and "decided to do away with the strict application/computation under [the] *grandfather rule*."[19] Despite this, the SEC has continued to adhere to the *grandfather rule*.

C. Dividing the Components of the Operation

A corporation operating a public utility or engaging in the development and utilization of minerals performs various activities. By carefully dividing the operations of these partially nationalized activities, full foreign equity participation may be allowed in the segments of a public utility or mining operations which are not at the core of the nationalized activity. For instance, foreign corporation may be allowed to construct and own the facilities of a public utility, so long as it does not hold the franchise to operate the public utility.[20] On the other hand, the processing of the ores may be done by a wholly-foreign owned corporation, as long as the actual

16. *Id.* (citations omitted.)
17. *Id.*
18. *Id.*
19. *See* SEC Opinion No. 64-03, Nov. 27, 2003 (emphasis supplied).
20. People v. Quasha, 93 Phil. 333 (1953); Tatad v. Garcia, Jr., 243 SCRA 436 (1995).

extraction of the minerals is done by a corporation with the required Philippine ownership.[21]

These techniques allow the foreign corporation to acquire a measure of control over the nationalized activity. For instance, the foreign investor of the public utility, which may be the owner of a public transportation system, may lease the public transportation system to the franchise holder and would also be able to set the price for such lease. Similarly, the foreign investor of a mining company may enter into an off-take agreement with the corporation engaged in mining, such that all the ores to be mined from the contract area will be sold to the foreign mineral processing corporation.[22]

III. Testing the Internal Consistency of the Treatment of Foreign Investment

The administrative stance of the SEC and even the DOJ has legitimized certain mechanisms by which foreign investors may retain a modicum of control over their investments. These mechanisms are traditionally relied upon by counsel in structuring investment vehicles, not only for private transactions, but also for transactions involving government infrastructure contracts and public bidding. However, a careful re-examination of these mechanisms shows apparent inconsistencies, not only with other administrative issuances or laws, but may have introduced readings of the Constitution that do not seem apparently conceived from a reading of the plain provisions thereof.

A. The Grandfather Rule v. the Foreign Investments Act

The *grandfather rule*, embodied in the 1976 SEC Rules and adhered to in administrative rulings, allows for foreign ownership of the Filipino component of the enterprise where foreign ownership is traditionally limited. The converse formulation of the 1967 SEC Rules, that if the

21. La Bugal-B'laan Tribal Association v. Victor Ramos, 445 SCRA 1 (2004).
22. Apart from the possible control that may be gained by retaining foreign ownership over the areas that are not considered the core of the nationalized activity, this mechanism may have also allowed foreign corporations to minimize the taxes they pay by transforming the expense of a related party to the income of another related party. Note that while Republic Act No. 8424, otherwise known as the National Internal Revenue Code (NIRC) currently contains provisions requiring transactions between related parties to be transacted at an arms-length basis, there are currently no regulations to implement the provisions on transfer pricing.

percentage of Filipino ownership in the corporation is at least 60 percent, then all the shares shall be counted as of Philippine nationality. This appears to be consistent with the FIA, when it provides that a corporation organized under the laws of the Philippines of which at least 60 percent of the capital stock outstanding and entitled to vote is owned and held by citizens of the Philippines is a Philippine national.

But the crucial difference is that in the *grandfather rule*, in order for a corporation to be considered a Filipino corporation, the ownership of such corporation is considered. As long as 60 percent of such corporation is Filipino owned, the whole corporation is considered Filipino. Thus, this makes possible the layering of corporate ownership, such that the Filipino component of the corporation undertaking the nationalized activity may itself be of 60 percent Filipino ownership and 40 percent foreign ownership. Under the FIA, however, what is expressly provided for is not mere Filipino ownership of 60 percent of the capital stock. The FIA provides that 60 percent of the capital stock is owned and held by *citizens of the Philippines*. Thus, there are two concepts at hand to consider – nationality and citizenship. While natural and juridical persons may have a nationality, only natural persons may be said to have citizenship, and only natural persons may be nominated as citizens. This inconsistency may appear cosmetic: minimum Filipino ownership might be met even if the ownership is not held by *citizens* but by *nationals*. Citizenship, even in its ordinary signification, connotes something that may be possessed only by natural persons, as it denotes possession, within a particular political community, of civil and political rights, imposing a duty of allegiance to the political community.[23] The grandfather rule will therefore have to withstand considerable scrutiny should its validity be challenged before courts.

There is another point of inconsistency between the FIA and the grandfather rule. A corporation 60 percent of whose *capital stock* that is outstanding and entitled to vote is owned and held by citizens of the Philippines, is a Philippine national under the FIA. By attaching two descriptive terms to *capital stock*, it seems that so long as Filipino ownership and vote entitlement is satisfied, then the corporation is free to create other permutations of stock ownership. Thus, the FIA appears to have sanctioned a scenario where a corporation engaged in a nationalized activity has two classes of stock, one class entitled to vote (hereinafter *Class A*), and another class not entitled to vote (hereinafter *Class B*). If 60 percent of *Class A* shares are held by Filipinos, and *Class B* shares held entirely by foreigners, then the

23. JOAQUIN G. BERNAS, THE 1987 CONSTITUTION OF THE PHILIPPINES: A COMMENTARY 609 (2003 ed.).

corporation would still be classified as a Filipino national under the FIA. This is a familiar scenario in Corporate Law, where a distinction is made between common shares which are entitled to vote but are given fewer privileges in terms of dividends and rights during liquidation, and preferred shares which are not entitled to vote but are given greater dividend privileges and other rights.

This scenario is clearly not contemplated under the formulation of the *grandfather rule*, which does not distinguish between shareholdings based on their entitlement to vote: "[i]f the percentage of Filipino ownership in the corporation or partnership is less than 60 percent, only the number of shares corresponding to such percentage shall be counted as of Philippine nationality."[24] Thus, the question presents itself – would this scenario theoretically allowed under the FIA be considered violative of the *grandfather rule*? Based on the hierarchy of laws alone, a position backed by the FIA, being a statute, would be stronger and would be sustained. But laws are enforced in the first instance by administrative agencies, and in this instance, the SEC has been plain in its position that the *grandfather rule* continues to apply.

B. The Foreign Investments Act v. the Constitution

The *Class A – Class B* share distinction earlier theorized to be sanctioned under the FIA may likewise be constitutionally infirm. A corporation where 60 percent of its capital stock that is outstanding and entitled to vote is owned and held by Filipino citizens, but with outstanding and non-voting stock held by foreigners, may not comply with the constitutional qualification to engage in the operation of a public utility. The Constitution provides:

> No franchise, certificate, or any other form of authorization for the operation of a public utility shall be granted except to citizens of the Philippines or to corporations or associations organized under the laws of the Philippines at least sixty per centum of whose capital is owned by such citizens...[25]

The Constitution provides no qualification as no distinction is provided between voting and non-voting stocks. The same is true for the constitutional qualification to engage in the exploration, development, and utilization of natural resources. The provision states that:

24. SEC Rules, ¶ 7 (1967).

25. PHIL. CONST. art XII, § 11.

> 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.[26]

The 60 percent capital pertains to the *subscribed capital* based on the following deliberations:

> MR. MAAMBONG. I would like to get clarification on this. If I remember my corporation law correctly, we usually use a determinant in order to find out what the ratio of ownership is, not really on the paid-up capital stock, but on the subscribed capital stock.
>
> For example, if the whole authorized capital stock of the corporation is P1 million, if the subscription is 60 percent of P1 million which is P600,000, then that is supposed to be the determinant whether there is a sharing of 60 percent of Filipinos or not. It is not really on the paid-up capital because once a person subscribes to a capital stock then whether that capital stock is paid up or not, does not really matter, as far as the books of the corporation are concerned. The subscribed capital stock is supposed to be owned by the person who makes the subscription. There are so many laws on how to collect the delinquency and so on.
>
> In view of the Commissioner's answer, I would like to know whether he is determined to put on the record that in order to determine the 60-40 percent sharing, we have to determine whether we will use a determinant which is the subscribed capital stock or the paid-up capital stock.
>
> XXX
>
> MR. ROMULO. We go by the established rule which I believe is uniformly held. It is based on the subscribed capital. I know only of one possible exception and that is where the bylaws prohibit the subscriber from voting. But that is a very rare provision in bylaws. Otherwise, my information and belief is that it is based on the subscribed capital.
>
> MR. MAAMBONG. My understanding is that in the computation of the 60-40 sharing under the present formulation, the determinant is the paid-up capital stock to which I disagree.
>
> MR. ROMULO. At least, from my point of view, it is the subscribed capital stock.
>
> MR. MAAMBONG. Then that is clarified.[27]

It is to be noted that even shareholders owning stocks denominated as non-voting retain the power to vote in certain instances where the acts contemplated are intimately connected with the corporate being.[28] One of these instances is when the corporation intends to sell, lease, exchange, mortgage, pledge, or to otherwise dispose all or substantially all of the corporate property, which is normally done when the corporation seeks to obtain project financing. Thus, foreign shareholders will have the power to approve which project lender will obtain the mortgage on the corporation's assets. If the constitutionality of this set-up is challenged, the sanction granted by the FIA may not stand against constitutional restraints.

26. PHIL. CONST. art XII, § 2.
27. II Journal, at 583-84.

IV. THE INSTITUTIONAL CHARACTER OF THE SEC AS AN ADMINISTRATIVE AGENCY

The risk that a contract, even one that has been entered into with the government itself, may be struck down as void and of no effect not merely due to nationality issues, is a specter that haunts all foreign investors. The taking of the risk is ultimately a business decision. In the case of nationality restrictions, foreign investors may exchange the power to retain a measure of control on the corporation engaged in the nationalized activity than what is ostensibly allowed by relying on administrative guidelines with the risk that these contracts may be voided. Thus, foreign investment relies greatly on the administrative agencies enforcing the guidelines that allow the entry of foreign investment.

The *grandfather rule*, and ultimately, the provisions of the FIA, are enforced by the SEC under its vast powers as provided under the Securities Regulation Code,[29] where, among others, the SEC shall:

> a) Have jurisdiction and supervision over all corporations, partnerships or associations who are the grantees of primary franchises and/or a license or permit issued by the Government;
>
> b) Formulate policies and recommendations on issues concerning the securities market, advise Congress and other government agencies on all aspects of the securities market and propose legislation and amendments thereto;
>
> c) Approve, reject, suspend, revoke or require amendments to registration statements, and registration and licensing applications;
>
> d) *Regulate, investigate or supervise the activities of persons to ensure compliance;*

28. CORPORATION CODE, § 6.
29. The Securities Regulation Code, Republic Act No. 8799 [SECURITIES REGULATION CODE] (2000).

e) Supervise, monitor, suspend or take over the activities of exchanges, clearing agencies and other SROs;

f) *Impose sanctions for the violation of laws and the rules, regulations and orders issued pursuant thereto*;

g) *Prepare, approve, amend or repeal rules, regulations and orders, and issue opinions and provide guidance on and supervise compliance with such rules, regulations and orders*;

h) Enlist the aid and support of and/or deputize any and all enforcement agencies of the Government, civil or military as well as any private institution, corporation, firm, association or person in the implementation of its powers and functions under this Code;

i) Issue cease and desist orders to prevent fraud or injury to the investing public;

j) Punish for contempt of the Commission, both direct and indirect, in accordance with the pertinent provisions of and penalties prescribed by the Rules of Court;

k) Compel the officers of any registered corporation or association to call meetings of stockholders or members thereof under its supervision;

l) Issue *subpoena duces tecum* and summon witnesses to appear in any proceedings of the Commission and in appropriate cases, order the examination, search and seizure of all documents, papers, files and records, tax returns, and books of accounts of any entity or person under investigation as may be necessary for the proper disposition of the cases before it, subject to the provisions of existing laws;

m) *Suspend, or revoke, after proper notice and hearing the franchise or certificate of registration of corporations, partnerships or associations, upon any of the grounds provided by law*; and

n) Exercise such other powers as may be provided by law as well as those which may be implied from, or which are necessary or incidental to the carrying out of, the express powers granted the Commission to achieve the objectives and purposes of these laws.[30]

The continued strength of the imprimatur of the SEC over the legitimacy of the arrangements that seem to go beyond what is plainly contemplated by statute or the Constitution speaks volumes of the faith on the SEC as an institution. These measures have apparently been considered under the Philippine legal landscape as reasonable, perhaps in recognition of the truism that a businessman who infuses resources would naturally wish to retain some manner of control over the same.

30. *Id.* § 5 (emphasis supplied).

Furthermore, while the Anti-Dummy Law[31] makes it a crime for any person, corporation, or association which allows any person, not possessing the qualifications to acquire, use, exploit, or enjoy through such person or corporation a right expressly reserved to citizens of the Philippines or to corporations or associations at least 60 percent of the capital of which is owned by such,[32] case law on the Anti-Dummy Act is not developed. The DOJ has considered certain acts to be significant indicators of dummy-status arising from a Presidential directive to the DOJ enumerating certain "indicators" of a dummy relationship. To wit, these indicators are:

1. That the foreign investors provide practically all the funds for the joint investment undertaken by these Filipino businessmen and their foreign partner;
2. That the foreign investors undertake to provide practically all the technological support for the joint venture; and
3. That the foreign investors, while being minority stockholders, manage the company and prepare all economic viability studies.[33]

However, the continued relevance of the first and second of these indicators of dummy relationship is suspect. Foreign involvement in nationalized activities is needed precisely because of the financial and technological support that it brings. An exhaustive search reveals that these measures of dummy relationship have been relied upon by the DOJ in only two of its opinions. Even then, it is not the province of the DOJ to issue its opinions on matters of private concern. Thus, it is still the SEC which holds the position of authority in the implementation of foreign investment laws. The great power that has been entrusted to the SEC, together with the faith at which its actions and issuances are taken, draws much from its status as an administrative agency.

The source of an administrative agency's authority is the theory that it is an expert in the issues with which it deals. Furthermore, due to the complexity of government regulations and functions, more and more administrative bodies, boards or tribunals specialized in the particular field assignment to them became necessary, so that the judge need not pass upon

31. An Act to Punish Acts of Evasion of Laws on the Nationalization of Certain Rights, Franchises or Privileges, Commonwealth Act No. 108 [ANTI-DUMMY LAW] (1936).

32. *Id.* § 2.

33. DOJ Opinion No. 141, series of 1974, Sep. 4, 1974; DOJ Opinion No. 165, series of 1984, Nov. 2, 1984.

matters in the first instance, or until the facts have been sifted and arranged.[34] Professor Jody Freeman of the Harvard Law School, writing on American Administrative Law, from which Philippine Administrative Law draws much from, says:

> Reconciling administrative power with democracy has long pre-occupied American administrative law scholars. Agencies inhabit a precarious position in the American separation of powers regime. They are the "headless fourth branch," for which scant provision is made in a Constitution that divides powers among the Congress, a unitary executive and the judiciary. Although not directly accountable to the electorate, agencies wield enormous discretionary power in the implementation of their delegated mandates; even the most specific statutes leave considerable room for interpretation and discretionary judgments. Because the American democratic system requires that the exercise of governmental authority be accountable to the electorate, administrative law has largely organized itself around the need to provide accountability indirectly through various mechanisms designed to discipline agency behavior, including legislative and executive oversight and judicial review. Nonetheless, uncontrolled agency discretion remains a constant threat to the legitimacy of the administrative state. It represents what might be called the traditional democracy problem in administrative law.[35]

The great power that has gradually been entrusted to administrative agencies has however been subject of long scholarly investigation as described by Professor Freeman. That the delegation of powers to administrative agencies is vast has been acknowledged as necessary as it is precarious. Reliance in good faith on opinions and issuances of administrative agencies does not protect parties even if they act in good faith in accordance with such issuances.[36] Furthermore, agencies may not be entirely insulated from political pressure, and an example of this is the Department of Environment and Natural Resources and the pressure that it is always subjected to from both governmental and non-governmental actors.

Even then, the supportive stance that the SEC has taken in favor of foreign investments has not been slavish and mindless. Recent issuances of the SEC, promulgated under its rule-making authority[37] reveal that even as it encourages capital investments, the SEC seeks to have investments and the

34. HECTOR DE LEON & HECTOR DE LEON, JR., ADMINISTRATIVE LAW: TEXT AND CASES 10-11 (2001 ed.).

35. Jody Freeman, Private Parties, Public Functions and the New Administrative Law, *at* http://ssrn.com/abstract=165988 (last accessed Sep. 1, 2006).

36. *See* Chavez v. Public Estates Authority, 384 SCRA 152 (2002).

37. CORPORATION CODE, § 143; SECURITIES REGULATION CODE, § 72.

activities that such investments spur to proceed and be pursued in good order. As such, it has issued the Code of Corporate Governance,[38] with the aim of raising investor confidence, developing the capital market and helping achieve high sustained growth for the corporate sector and the economy.[39] The Code of Corporate Governance sets out precise duties of the directors in the corporation — imposing the duty of *governance*,[40] mandating the Board of Directors to *enhance the value of the corporation*.[41] It further mandates that the Board needs to be structured so that it provides an independent check on management. It then recognizes that it is vitally important that a number of board members be independent from management.[42]

The Code of Corporate Governance further gives to the corporation's stakeholders, the parties who contribute to the corporation's status as a growing concern, important rights to ensure that the Board of Directors enhance the value of the corporation. Some of these are:

1. The right to demand that the Board of Directors engage in their role of corporate governance,[43] where stakeholders, together with shareholders and creditors, "ensure that management enhances the value of the corporation as it competes in an increasingly global market place."[44]

2. The right to expect that the institution is being run in a prudent and sound manner;[45]

3. The right to demand that the Board conduct itself with utmost honesty and integrity in the discharge of its duties, functions and responsibilities which includes the right to demand that there be a clear policy on communicating or relating with them accurately, effectively and sufficiently;[46]

The SEC recognizes that in order for corporate stakeholders to fully realize their right to expect the Board of Directors to enhance the value of

38. Code of Corporate Governance, SEC Memorandum Circular No. 2, series of 2002.

39. *Id.* Preamble.

40. *Id.* § I b.

41. *Id.* § II.

42. *Id.*

43. *Id.* § II.

44. Code of Corporate Governance, § I (1) b.

45. *Id.* § II (6) a.

46. *Id.* § II (6) b & b (iv).

the corporation, it has increased the stringency of disclosure requirements not only on public corporations, which are those covered by the Code of Corporate Governance where the initial steps towards making the Board of Directors more accountable to its stakeholders have been taken, but also on all corporations. Thus, the SEC has required the disclosure of additional matters in the corporation's General Information Statement (GIS) prescribing a specific computer format. It has also required certain corporations, including those with gross sales or revenue of at least Php5 million, to submit an electronic copy of its GIS, its General Form for Financial Statements, and the industry specific Special Forms for Financial Statements.[47] Even non-stock corporations have been required to file their GIS in a prescribed electronic format.[48]

Both the Corporation Code and the Securities Regulation Code recognize the rule-making power of the SEC.[49] The Securities Regulation Code even seems to have granted SEC the discretion to override the prohibitory or mandatory rules of the Securities Regulation Code itself, and the power to suspend the application of the Corporation Code.[50] Furthermore, rules duly promulgated by an administrative agency such as the SEC has the force and effect of law.[51]

The persuasive effect of SEC is imperative in maintaining the current atmosphere for foreign investment. The current mechanisms in place that allow foreign investors to acquire a modicum of control over their investments are necessary if the Philippines is to be seriously considered for foreign investments. This is necessary because, unlike creditors whose interests can be contractually protected, foreign financial resources that flow into the Philippines as investment, is considered capital and as such, is subject to the *trust fund doctrine*, requiring the paying-off of indebtedness and obligations to creditors and the government before any gain or return of the capital may be realized. The existence of such rules and the continuous enforcement of these rules by a powerful agency are important, considering the xenophobic tendencies toward foreign investors that exist up to this day.

47. SEC Memorandum Circular No. 6, series of 2006.

48. SEC Memorandum Circular No. 2, series of 2006.

49. CORPORATION CODE, § 143; SECURITIES REGULATION CODE, § 72.

50. CESAR L. VILLANUEVA, LEGAL AND REGULATORY ISSUES FOR DIRECTORS OF PUBLIC CORPORATIONS 15 (2002 ed.).

51. Cebu Institute of Technology v. Ople, 156 SCRA 692 (1987); Victorias Milling Co. v. Zayco, 17 SCRA 316 (1966); Macailing v. Andrada, 31 SCRA 126 (1970).

V. CONCLUSION

During the deliberations of the constitutional commission on the 1987 Constitution, Former Chief Justice and then Commissioner Hilario Davide, Jr., in support of his proposal to exclude all foreign participation in the exploration, development, and utilization of natural resources, explained his proposal:

> In the Preamble we clearly stated there that the Filipino people are sovereign and that one of the objectives for the creation or establishment of a government is to conserve and develop the national patrimony. The implication is that the national patrimony or our natural resources are exclusively reserved for the Filipino people. No alien must be allowed to enjoy, exploit and develop our natural resources. As a matter of fact, that principle proceeds from the fact that our natural resources are gifts from God to the Filipino people and it would be a breach of that special blessing from God if we will allow aliens to exploit our natural resources.[52]

Even as the world moves towards an era of globalization, the spirit that animates our laws is still a thinking limited to local shores. Even if Philippine natural resources were to be exploited only for Filipinos, this would still require large amounts of capital investments. This capital does not appear to be forthcoming from Philippine sources, either as lenders or investors. Thus, foreign investment continues to be needed, or rather, imperative, for infrastructure and development projects.

The SEC regulates the entry of foreign capital in the Philippines and, through certain legal mechanisms, allows for control mechanisms to be in place to provide foreigners a means of controlling investments that are arguably beyond the contemplation of law. Even as administrative rules have the force and effect of law, courts retain judicial power to oversee whether the exercise of discretion by all instrumentalities of the government is in grave abuse, and any action that is done without or in excess of jurisdiction is still subject to judicial review. This essay examines the apparent inconsistencies that appear to exist in the means that have been recognized to grant foreigners control over their investments. But these measures gain persuasive effect from the institutional strength of the SEC as the enforcer of corporate laws and the inertia of its support towards foreign investment.

52. II Journal at 385.

The faith of the market in the SEC is awe-inspiring. Based on the 2005 Social Weather Stations Survey of Enterprises on Corruption,[53] the SEC ranked the highest among twenty-six government agencies in "sincerity in fighting corruption" in a sample of Filipino managers throughout the Philippines. The SEC has consistently rated at least +50 in Net Sincerity, placing it at the highest rank in the survey of government agencies.[54] Through its recent issuances requiring greater disclosure, it seeks to avoid the recurrence of financial failures of entire industries going undetected. The credibility of the current system is held in place by the resolve of the SEC as an institution to strike a balance between allowing reasonable foreign control mechanisms over their foreign investments and preventing foreign investment from proceeding towards the route that both the courts and the framers of law fear. It thus appears that the future trends of foreign investment will matter greatly with how well the SEC is able to prosecute its mandate.

53. 2005 Social Weather Stations Survey of Enterprises on Corruption, *at* http://www.tag.org.ph/pdf/SWS_2005th_Survey.pdf (last accessed Sep. 1, 2006).

54. Net Sincerity is defined in the survey as the difference between the percentage rating an agency obtains that it is Very/Somewhat Sincere and the percentage rating it obtains that it is Very/Somewhat Insincere. It rangers between +100 for a unanimous rating of sincere and −100 for a unanimous rating of insincere. A +50 rating is classified as Very Good. Since 2001 when the SEC was listed in the survey, it has consistently scored Very Good.

WTO Compliance Review: Proposed Amendments to the Intellectual Property Code of the Philippines

Jennifer Joy C. Ong★

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I. INTRODUCTION

The balance between the public's access to medicine and the protection of the rights of intellectual property holders has been the subject of numerous debates and controversies worldwide. The Philippines has not been spared from this debate. Recent developments in the country have exemplified the challenge of balancing these two interests.

The Philippines signed and ratified the Uruguay Round Final Act in 1994 and thus adopting the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS Agreement).[1] In compliance with its

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