LIMITATIONS ON FOREIGN EQUITY PARTICIPATION IN THE EXPLOITATION OF NATURAL RESOURCES IN THE PHILIPPINES: *QUO VADIS?**

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INTRODUCTION

Ever since reading Justice Oliver Wendel Holmes' The Common Law (a required first year law student's reading at my alma mater), I have become fascinated with how the law has evolved in theory and in practice. At times what is theoretically sound is not necessarily feasible in the real world. Conversely, what works in practice is not necessarily still possessed of theoretical validity. The latter is specially true when the rationale for a particular rule of law has been rendered meaningless by the cobwebs of time.

I also agree with a corollary observation of Justice Holmes that the "law embodies the story of a nation's development". For this reason, I have chosen the area of natural resource law to demonstrate the development of my country as its world becomes increasingly internationalized through foreign investments in its natural resource industries. I hope this paper will be able to show some of its concerns, aspirations, problems and solutions. In my study, the approach I have adopted is basically historical and policy-oriented.

I. THE ROLE OF THE MINING INDUSTRY IN THE PHILIPPINE ECONOMY

The Philippines is one of the eight Pacific Rim countries that sit atop the so-called Rim of Fire — a strip that runs from Japan southward to

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New Zealand.[1] According to geologists, a substantial concentration of gold and other mineral deposits can be found within this strip.[2] Indeed, the Philippines finds itself to be highly mineralized and rich in natural resource wealth. Records show that the Philippines has abundant reserves of 13 known metallic metals and 29 non-metallic minerals.[3] "The metallic sector of (the Philippine) mining industry includes gold,[4] copper,[5] chromite,

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[1]Lee, *New Gold Fever Has a Grip on the Philippines; Commodities: Dozens of Foreign Firms Have set up Mining Operations in the Islands*, Los Angeles Times (Sunday, Home Edition), October 7, 1990, Part I, Page 1, Column 5.

[2]*Id.*

[3]News Highlights, *Suppliers Eye $50-Billion Market in Mining*, Phil. Mining & Eng'g. J 5 (November-December 1990).

[4]For many years, the Philippines has ranked and still ranks among the 10 largest producers of gold. "Dozens of foreign companies have set up mining operations in the (Philippines), which is believed to have one of the world's richest gold deposits. The Philippines is second only to South Africa in the concentration of gold deposits discovered per unit of land." (Lee, *supra* not 1, at 1).

Gold production in the Philippines "in 1975 was 16.1 tonnes, in 1980, 22 tonnes, in 1982, 31.0 tonnes, in 1984, 34.3 tonnes, in 1986, 39.9 tonnes" (Data from Consolidated Gold Fields PLC cited in Gold in the S.W. Pacific, Mining Magazine 388 (May, 1988; NEXIS)). The annual market review "Gold 1991" based on research conducted by GoldFields Mineral Services reports the following ranking for the top ten countries in gold production (in metric tons) for 1989 and 1990:

1989	1990	Country	1989	1990
1	1	South Africa	607.5	605.4
3	2	United States	265.5	295.0
2	3	Soviet Union	285.0	260.0
4	4	Australia	203.6	241.3
5	5	Canada	159.5	165.0
7	6	China	86.0	95.0
6	7	Brazil	101.2	78.0
8	*8*	*Philippines*	*38.0*	*37.2*
9	9	Papua New Guinea	33.8	33.6
10	10	Columbia	31.7	32.5

(Source: South Africa Still No. 1 in Gold Top Ten, The Reuters Business Report, May 21, 1991, Tuesday, BC Cycle (NEXIS))

Philippine gold production in 1990 was lower than initial projected figures due to landslides caused by earthquakes and strong typhoons during the year. (Hutchinson, Oil Shortage and Earthquake Hit Gold Output, Financial Times, November 2, 1990, at 32) Gold production in the Philippines is expected to go up to 41 tonnes in 1992 and 45 tonnes by 1995 (Gold Supply Forecast, Mining Journal, October 19, 1990, at 299).

[5]Copper concentrate remains one of the country's top foreign exchange earners and the Philippines continues to be Asia's top copper producer and one of the 10 biggest copper

nickel, lead and iron ore producers. The non-metallic producers are largely, permittees and licensees of limestone, fertilizers, clay, sand and gravel, rock phosphate, marble, etc."[6] As of December, 1990, reserves of gold are estimated at 109 million metric tons (mt), copper at 4.1 billion mt, chromite, 27.5 million mt, and nickel, 1.6 billion mt.[7]

In addition to minerals, the Philippines might also possess large quantities of natural gas.[8]

Philippine Mineral Output[9]
(in thousands)

	1987	1988	1989
Gold (kg)	32,599	32,486	30,237
Silver (kg)	50,933	54,727	46,370
Copper-in-concentrate	215,800	218,202	189,500
Zinc-in-concentrate	1,128	1,569	2,459
Nickel (metal)	9,117		
Nickel (ore)	367,854	432,898	561,000
Chrome ore	188,297	182,242	189,500
Manganese ore	445	670	

producers in the world (Philippines' Growing Mining Industry, in Xinhua General Overseas News Services, July 3, 1989, (NEXIS)).

[6]*Ibid.*

[7]News Highlights, *supra* note 3, at 5.

[8]In 1989, Occidental Petroleum of the United States ("Occidental") and Royal Dutch Shell ("Shell") of Netherlands discovered potentially large gas deposits in Cadlao, offshore northwest Palawan. Late last year, they made two additional major natural gas discoveries (Camago and Malampaya fields) on the same island. Exploration drilling has indicated that the Camago field alone contains probable reserves of 1.2 trillion cubic feet (tcf) with 243 m barrels of gas condensate. Occidental and Shell, along with the Philippine government, are presently hoping exploration drilling planned for this year at nearby Malampaya field will cgwfirm the presence of additional natural gas reserves totalling more than 6 tcf in volume as well as gas condensate deposits. Further exploratory drilling on the island of Palawan this year could confirm additional natural gas reserves, estimated at 10 tcf. In the next five years, the Philippines plans to substitute the Palawan gas for imported oil used for power generation. (Philippines Pins Gas Hopes on Palawan Field, The Financial Times Limited, 1991; Power Asia, April 8, 1991 (NEXIS). *See* also Oil Strikes Offers Hope for Economy, Philippine News, January 16-22, 1991, at 13, col. 3. The Philippine News reported on a major oil discovery late 1990 in West Linapacan (southwestern Philippines) that is expected to recover oil reserves of up to 200 million barrels.)

[9]Source: Disini, The Philippines, MINING ANNUAL REVIEW 108 (June, 1990).

Cement (000 t)	3,320	4,300	4,500
Coal (000 t)	1,169	1,330	1,330
Silica (sand)	213,407	177,304	190,000
Bentonite	1,425	1,562	1,570

With so much natural resources, it is not surprising that the Philippine government has assigned the mining industry a key role in its national economy recovery program.[10] The industry contributes directly to national economy through its foreign exchange earnings and tax payments."[11] Its indirect contributions include the generation of employment, construction of infrastructures, donations to charity, utilization of local materials (backward linkages), patronage of ancillary industries (lateral linkages).[12]

Export Earnings.

According to the latest available statistics, the Philippines' gross national product amounted to US$42,583,300,000 in 1989. For the same year, its gross domestic product (GDP) was US$ 42,922,000,000. The same source shows Mining as representing 1.51% of the Philippines' GDP.[13] Unfortunately, 1989 was a lack-lustre year in Philippine mining with the industry posting very minimal (0.76%) gains.[14] According to the Philippine Bureau of Mines & Geosciences this performance was attributable to unfavorable conditions brought about by higher inflation and interest rates, power interruptions and relatively lower price quotations of metals in the international market during this period.[15]

Total export earnings for 1989 as reported by the Bureau of Mines and Geosciences were up by 11.73% from US$ 1.07 billion to US$ 1.19 billion.[16] The foreign exchange rate at this time was Philippine Pesos (₱) 22.37 to US$1.00.[17] This, however, represents a slight output value decline

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[10]Mining to Play Key Role in Economic Recovery, Business Day, May 29, 1987, at 1, col. 1.

[11]Major Contributor: Mining Firms Spur Economic Progress, Business Day, May 29, 1987, at 5.

[12]*See Id.*, at 5-6.

[13]*Supra* note 9.

[14]Country Profile: Philippines, KCWD (c) 1991 ABC-Clio, Inc. (NEXIS: Load: May 21, 1991).

[15]*Id.*.

[16]*Id.*

[17]*Id.*

by 1.12% compared to 1988.[18] The biggest contributor in mining is usually the metallic group which accounts for 99% of the country's total export earnings.[19] In 1989, the major contributors to export earnings were gold and copper.[20] Gold and silver by themselves, showed a total contribution of 33.22% among the metallic export group.[21] On the other hand, "the non-metallic group was able to achieve modest gains as production went up by 8.8% from P4.13 billion in 1988 to P4.50 billion in 1989. The improvements from the non-metallic group came from mining bentonite, limestone and silica for cement manufacture and construction materials such as sand and gravel."[22]

Currently, the Philippine mining industry earns approximately $ 1 billion a year. This is expected to increase within the next few years following increased foreign investments.[23]

Taxes.

Among the major taxes, duties and other fees that the Philippine mining industry pays to the national government each year are corporate income tax, ad valorem or royalty tax, export premium and customs duty, compensating tax, wharfage fee, social security and medicare payments, mine waste and tailings fee, occupation fee or rentals, final tax on interest income and withholding tax on foreign loans.[24] It also pays realty property tax, business and percentage taxes, municipal taxes and residence tax to the local government.[25]

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[18]*Id.*

[19]SyCip Gorres & Velayo (SGV accounting firm), Executive Summary: Mining and Ore Dressing, Long Term Sectoral Plan 1-2, (a study commissioned by the Philippine Board of Investment. Hereinafter cited as the SGV Study [1988]).

[20]Disini, *supra* note , at 108.

[21]*Id.*

[22]*Id.*

[23]News Highlights, *supra* note, at 5. Over the first six months of 1990 alone, foreign investment reached S126 million with primary sources of investment being led by companies from Japan, the United States, Taiwan and Hongkong.

[24]A Major Contributor: Mining Firms Spur Economic Progress, Business Day, May 29, 1987, at 5. In 1989, the total mining taxes (excise) collected by the Philippine Bureau of Internal Revenue amounted to Philippine Peso (P) 711,407,469.83 (approximately US $ 26 million today) (Bureau of Internal Revenue, 1989 BIR ANNUAL REPORT 30 (1990)). On inquiry through the proper channels, the comparable figure for 1990 is estimated at P838,925,851.58 (or approximately US $31 million.) I have assumed an exchange rate of PP 27.00 to US$ 1.00. Unfortunately, other figures are not available.

[25]*Id.*

Job Generation

The Philippine mining industry now "directly employs about 50,000 persons.[26] More than 50% are employed in copper mining firms, while gold and silver accounts for 20%."[27]

The future is far from dim in the Philippine mining industry. According to industry experts, some areas in which the Philippine mining industry is exceptionally strong are:

> 1. Professional competence of technical personnel, particularly in the area of production management. About 99% of the operating management is in the hands of the Filipino engineers who are generally rated very good at their work. A number of Filipinos are holding responsible positions in mines all over the U.S., Canada, Australia and Africa.
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> 2. Geography - The Philippines is not only highly mineralized but also consists of a fairly narrow band of tropical islands, which means that both water supply and ocean transportation are easily accessible from almost any part of the country. Another advantage is the Philippines' proximity to Japan, which is the world's largest consumer of imported minerals.
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> 3. Labor - x x x relatively high quality, and low cost skilled labor which can be trained to meet the mining industry's requirements.
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> 4. The Philippines mining companies have proven to be reliable suppliers to smelters in Japan, the U.S., China, South Korea and Taiwan. Commercial disputes or contract cancellations have been the rare exception rather than the general rule.
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> 5. Availability of government-supplied energy from the National Power Corporation power grid to Luzon and Mindanao users.[28]

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[26]Philippines' Growing Mining Industry, Xinhua General Overseas News Services, July 3, 1989 (NEXIS). It can be safely assumed that for every employee, there are approximately four dependents. According to the same news report, this industry employment figure does not even include about 200,000 rural people who have left traditional avenues of livelihood for gold panning operations, particularly in the mountains of Mindanao, Southern Philippines.

[27]*Id.*.

[28]SyCip Gorres & Velayo (SGV accounting firm), Executive Summary: Mining and Ore Dressing, Long Term Sectoral Plan 1-2, (a study commissioned by the Philippine Board of Investment [1988]).

> In terms of comparative advantage, the Philippines has good sources of copper and nickel, and moderate extraction cost because of its low labour costs. In processing, its main activities are nickel refining, copper smelting, and petroleum refining, but these activities are to some extent disadvantaged by relatively high energy costs and dependence on imported crude oil for the production of refined petroleum products. The copper smelter-refinery has the advantage of access to cheap geothermal power and could, at least potentially, be an economic producer and exporter. Limitations of efficiency and operational scale are factors that have tended to work against the Philippines in the past in capitalising on its comparative advantages in copper and nickel.[29]

On the other hand, the Philippine mining industry faces several problems in its further growth. "The ecological issue, for one, has cropped out. For example, Marcopper Mining Corporation was closed down in April, 1988 because its tailing disposal system was allegedly polluting Calacan Bay in Marinduque. Benguet Consolidated and Philex Mining face similar charges of polluting rivers near their mining areas."[30] Furthermore, other industry weakness experts pointed out are --

> 1. Unfavorable debt-to-equity ratio characteristic of nearly all mining companies in the country. This problem was further exacerbated by prohibitive costs of long-term loans which severely affected the companies cash flows. This together with the depressed metal prices contributed to the closure of several mines.
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> 2. The delay in the decision on mining claims conflict has slowed exploration of some mineral prospects.
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> 3. The prohibitive cost of setting infrastructure in remote areas together with the high cost of generating power in these areas has contributed to high investment and operating costs.
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> Unfavorable effect of exchange rate fluctuations. Since the cost structure of the mining firms is mostly import-related, mining firms are vulnerable to exchange rate fluctuations.[31]

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[29]Santos, The Philippines, in MINERAL PROCESSING IN THE INDUSTRIALISATION OF ASEAN AND AUSTRALIA 254 (Bruce Mckern & Praipol Koomsup ed. 1988).

[30]Philippines' Growing Mining Industry, Xinhua General Overseas News Services, July 3, 1989 (NEXIS).

[31]SyCip Gorres & Velayo (SGV accounting firm), Executive Summary: Mining and Ore Dressing, Long Term Sectoral Plan 3 (a study commissioned by the Philippine Board of Investment [1988]).

In a survey conducted between 1989 and 1990 by Dr. Charles Johnson of the East-West Center ranking countries for minerals exploration, the Philippines was ranked third in terms of geologic potential – above Brazil, Argentina, Mexico, Bolivia, Venezuela, Burma, Indonesia, U.S.S.R., Zaire, Chile, Colombia, Thailand, and Ecuador, losing only to China and Peru.[32] In terms of best investment climates among Asian countries, it came in third among the top three below Indonesia and Thailand.[33]

Indubitably, there is a significant amount of interest among foreigners in the natural resource wealth of the Philippines. With respect to interested foreign investors, it is hoped that this study will contribute to a better understanding of the present legal environment affecting Philippine natural resource exploitation. On the other hand, with respect to policy makers within the government, it is hoped that this seminal work will provide some small measure of guidance in determining the appropriate legal structures or policies that should govern foreign investments in this area.

II. WINDS OF CHANGE: THE INTERNATIONAL SETTING

From its inception, the mining industry has always had an international character. Historically, a high degree of interdependence and conflict between nations mark the exploitation of natural resources. In view thereof, any meaningful comprehension of the Philippine mining industry and the legal framework that gradually envelops it, would be deficient without an initial understanding of contemporaneous international developments.

The most relevant period for study would be the post-World War I years of the 20th century. This period had witnessed the birth of more new nations than any other time continuum of human history. Many of these new nations had had to pass through the crucible of decades of exploitative colonial rule before they finally gained back their political independence. In the years after nationhood was realized, a lot of them learned, with bitterness, the full extent of exploitative plunder their past colonial masters had wrought on their country's resources. It was thus not surprising that

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[32]Johnson, Ranking Countries for Minerals Exploration, MINING JOURNAL 15, May 15, 1990 (NEXIS).

[33]*Id.*

during the nascent years of decolonization, this revived sense of outraged nationalism translated itself inter alia into the concept of Permanent Sovereignty over Natural Resources.[34] This concept of resource nationalism had its beginnings in the 1950s, barely a decade after the United Nations was founded. It started as a demand by developing countries for economic independence at the Eighth Session of the Human Rights Commission in 1952. "The majority of Afro-Asian members of the Commission felt that the right of peoples and nations to self-determination should not be regarded solely from the political viewpoint but should also be considered from the economic aspect because political independence is meaningless without economic self-determination or economic independence. Therefore, the right of peoples and nations to freely dispose of their own natural resources had to be recognized as an essential element of political independence."[35] The concept rejected the idea of investor ownership or control over a state's natural resources.[36] It involved a new approach to foreign participation in natural resource utilization, the basic requirements of which are:

> 1) It must be in the interest of national development and well- being of the people of the state concerned.
>
> 2) It must be in accordance with national legislation.

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[34]This principle has been formulated, debated, developed and reiterated in numerous resolutions of the United Nations General Assembly. These are: No. 523 (VI) of 12 January 1952; No. 626 (VII) of 21 December 1958; No. 1314 (XIII) of 12 December 1958 which created the Commission on Permanent Sovereignty Over Natural Resources to find a consensus between capital exporting and capital importing states. The Commission was composed of representatives from Afghanistan, Chile, Guatemala, Netherlands, *Philippines*, Sweden, United Soviet Socialist Republic, United Arab Republic (Egypt) and the United States of America. No. 1515 (XV) of 15 December 1960; the "landmark resolution" No. 1803 (XVII) of 14 December 1962; No. 2158 (XXI) of 25 November 1966; No. 2386 (XXIII) of 19 December 1968; No. 2692 (XXV) of 11 December 1970; No. 88 (XII) of 19 October 1973 adopted by the Trade and Development Board of the UNCTAD; No. 3016 (XXVII) of 18 December 1972; No. 3037 (XXVII) of 19 December 1972; No. 3082 (XXVIII) of 6 December 1973; No. 3171 (XXVIII) of 17 December 1973; No. 3201 and 3202 (S-VI) of 1 May 1974 otherwise known as the Declaration on the Establishment of a New International Economic Order. This process culminated in the incorporation of the principle of permanent sovereignty over natural resources in Article 2 of the Charter of Economic Rights and Duties of States which was adopted by the General Assembly in Resolution No. 3281 (XXIX) of 12 December 1974.

[35]1 M. Munansangu, SOVEREIGNTY OVER AND JUST PRICES FOR NATURAL RESOURCES WITH EMPHASIS ON AFRICAN STATES 87 (1981) *citing* Banerjee, The Concept of Permanent Sovereignty Over Natural Resources -- An Analysis, 8 Indian J. Int'l L. 515.

[36]Asante & Stockmayer, EVOLUTION OF DEVELOPMENT CONTRACTS: THE ISSUE OF EFFECTIVE CONTROL 53 (1984).

3) It must be freely entered into.[37]

In the years that followed, the deliberations thereon run the gamut of polarized views. On the one hand, there were those who called for the unlimited or Austinian exercise of permanent sovereignty over natural resources with the concomitant absolute right on the part of the state to expropriate or nationalize foreign entities engaged in the exploitation of natural resources in its territories. On the other hand, others (mostly, capital- exporting states such as the United States and United Kingdom) adhered to a more limited concept of permanent sovereignty that would accord due regard to the doctrine of acquired rights and the payment of appropriate compensation in cases of state expropriation.[38] The latter view eventually got the majority vote due to overriding pragmatic considerations. Many former colonies, in their interest to cultivate new economic relationships with former colonial powers whose nationals were the source of foreign private investment, decided to proceed with caution by either abstaining from voting or by taking sides with capital-exporting countries.[39] Notwithstanding this compromise, it cannot be gainsaid that substantial headway was achieved by the new developing states with the recognition of the right of permanent sovereignty over natural resources. Indeed, "the transition of the major raw material countries from colonial or quasi-colonial status to political independence has meant the end of a long period of relative -- and sometimes nearly complete -- *laissez faire* of direct foreign investment."[40] "The resolutions introducing the fundamental concepts of sovereignty and control over natural resource exploration offer developing countries support as these countries attempt to translate their recently won

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[37]U.N. General Assembly Resolution No. 1803 (XVII) of 14 December 1962. The concession agreement was the prevailing arrangement at that time. "The concessionaire was typically granted extensive rights over a very large land area, often much larger than an investor could be expected to develop within a reasonable period. The period for the contract was, however, seldom reasonable: in many the terms were to run for fifty or sixty years or more." (*See* D. SMITH & L. WELLS, NEGOTIATING THIRD WORLD MINERAL AGREEMENTS: PROMISES AS PROLOGUE 31 (1975)).

[38]*See* 1 Munansangu *supra* note 35, at 85 to 158 for a detailed analysis of the deliberations and issues made on the floor of the U. N. General Assembly in connection with the concept of permanent sovereignty over natural resources. Special emphasis was given in Mr. Munansangu's S.J.D. thesis to the votes and action taken by the African States.

[39]*Id.*, at 102.

[40]Morse, POTENTIALS AND HAZARDS OF DIRECT INTERNATIONAL INVESTMENT IN RAW MATERIAL, IN NATURAL RESOURCES AND INTERNATIONAL DEVELOPMENT 373 (Clawson Marion ed. 1964).

political independence into resource policies conceived and implemented to promote national development objectives."[41]

Given the "felt necessities of the time" and "the prevalent moral and political theories"[42] in the international arena, one would now be in a better position to appreciate the legal developments in the Philippines with respect to the imposition of foreign equity restrictions in the exploitation of Philippine natural resources.[43]

III. PHILIPPINE CONSTITUTIONAL UNDERPINNINGS

The current limitations on foreign equity participation in Philippine natural resource exploitation have their roots in nothing less than the fundamental law of the land. Variations of these limitations appear in the 1935, 1973 and 1987 Philippine Constitutions. To relish the full nuances of these restrictions, we must perforce "alternately consult history and existing theories of legislation"[44] in this respect.

(1) The 1935 Philippine Constitution

The Republic of the Philippines was one of the younger members of the community of nations after World War II. It was a Spanish colony for almost four centuries – from 1521 to 1898. During the Spanish regime, the disposition, exploration and development of mineral lands was governed by the Royal Decree of May 14, 1867. Under Article 339 of the Codigo Civil (Spanish Civil Code), mines and mineral lands were susceptible of private appropriation by means of royal grants. The Regalian Doctrine was followed. This means that minerals belong to the State wherever they may

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[41]Asante & Stockmayer, *supra* note 36 at 54.

[42]O. W. Holmes, Jr., THE COMMON LAW 1 (1881).

[43]According to a leading Philippine constitutional historian, Jose M. Aruego, "precedents for the principles [appertaining to Article XIII (Conservation and Utilization of Natural Resources) of the first Philippine Constitution] can be found in the Constitutions of Mexico, Germany, Spain, Ireland, and Czechoslovakia. There were also contemporaneous movements in several foreign countries directed either by constitutional provisions or by statutory laws for carrying out into practice these principles." (J. ARUEGO, THE PHILIPPINE CONSTITUTION: SOURCES, MAKING, MEANING AND APPLICATION 253 (1969-1972)). This indicates that the prevalent political theories of the time on the world stage influenced in no small measure the drafters of the first Philippine Constitution.

[44]O.W. HOLMES, *supra* note 42, at 1.

be found, whether in public lands or in private lands. For the purpose, however, of prospecting on private property the permission of the owner was necessary. Notwithstanding, in case of refusal by the latter the government might be called upon to intervene.[45]

In 1898, the United States defeated Spain in the Spanish-American War. As a result, the Philippines became an American colony under the Treaty of Paris.[46] During the American occupation the fundamental law on mining was incorporated in the Philippine Bill of 1902, approved by the United States Congress on July 1, 1902, and subsequently amended on February 6, 1905. Pursuant to the grant of authority under the Philippine Bill of 1902, the Philippine Commission, then the law-making body, approved Act No. 624 which recognizes the Regalian Doctrine. Thus, "the disposition of minerals of the public domain was reserved to the State. They were not open to exploration, occupation and exploitation except only to citizens of the United States and of the Philippines."[47] Mineral lands were disposed of by the freehold or patent system. This system proved to be counterproductive and conducive to claim-jumping and highgrading.[48]

In 1935, the Philippines became a self-governing Commonwealth under United States control. "Briefly stated, the steps which led to the drafting and adoption of the 1935 Constitution of the Philippines are as follows:

> (a) Approval on March 24, 1934 by President Franklin D. Roosevelt of the Tydings-McDuffie Law, otherwise known as the Philippine Independence Act, enacted by the United States Congress, authorizing

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[45]N. PENA, PHILIPPINE LAW ON NATURAL RESOURCES 84 (1982).

[46]Country Profile: Philippines, KCWD (c) 1991 ABC-Clio, Inc. (NEXIS: Load: April 24, 1991.)

[47]N. PENA, *supra* note 45, at 84.

[48]In fact, the freehold system was severely criticized by Delegate Ventura during the 1935 Constitutional Convention interpellation, thus,

> "Under the present Mining Law, our mineral lands are disposed of by the freehold system. In other words, a patent is issued to the mining corporation, which then holds the claim for all time. You will remember that there is a rush for staking mineral claims, and only those able to put up stakes get these claims. These mining corporations sometimes spring up like mushrooms. *They do not have the necessary capital, and yet after a little development on the mining claim, they are issued a patent. Even if the mine is not fully developed, all the valuable wealth is extracted by the mining companies (highgrading), leaving a barren land....This system now in vogue, by absolute title, is prejudicial to the interests of the people.*" (J. ARUEGO, *supra* note 43, at 267-268; emphasis and parenthetical remark supplied).

> the Philippine Legislature to call a constitutional convention to draft a constitution for the Philippines;
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> (b) Acceptance on May 1, 1934 by the Philippine Legislature by concurrent resolution of the Tydings-McDuffie Independence Law as required in said law;
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> (c) Approval on May 5, 1934 by the Philippine Legislature of a bill calling a constitutional convention as provided for in the Independence Law;
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> (d) Election on July 10, 1934 of delegates to the convention;
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> (e) Inaugural session on July 30, 1934 of the Constitutional Convention;
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> (f) Approval on February 8, 1935 by the convention by a vote of 177 to 1 of the constitution (the signing began on the following day and was completed on February 19, 1935);
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> (g) Submission on March 18, 1935 of the constitution to President Franklin D. Roosevelt by a committee composed of Senate President Manuel L. Quezon, Convention President Claro M. Recto, and delegate Manuel A. Roxas;[49]
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> (h) Approval on March 23, 1935 by President Roosevelt of the Constitution as submitted to him, together with a certification that the said Constitution conformed with the provisions of the Independence Law; and
>
> (i) Ratification on May 14, 1935 of the constitution by the Filipino electorate by a vote of 1,213,046 with 44,963 against.[50]

Section 1, Article XIII of the 1935 Constitution limited foreign equity participation in the "disposition, exploitation, development or utilization of natural resources" as follows:

> All agricultural, timber and mineral lands of the public domain, waters, minerals, coal, petroleum, and other mineral oils, all forces of potential energy, and other natural resources of the Philippines belong to the State, and their disposition, exploitation, development, or utilization

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[49]Quezon and Roxas subsequently became Presidents of the Republic of the Philippines.

[50]H.S. DE LEON, TEXTBOOK ON THE NEW PHILIPPINE CONSTITUTION 31-32 (1989).

shall be limited to citizens of the Philippines, or *to corporations or associations at least sixty per centum of the capital of which is owned by such citizens,* subject to any existing right, grant, lease or concession at the time of the inauguration of the Government established under this Constitution. Natural resources, with the exception of public agricultural land, shall not be alienated, and *no license, concession or lease for the exploitation, development, or utilization of any of the natural resources shall be granted for a period exceeding twenty-five years, renewable for another twenty-five years,* except as to water rights for irrigation, water supply, fisheries, or industrial uses other than the development of water power, in which cases beneficial use may be the measure and the limit of the grant.

"The basic rationale for the nationalization of the natural resources of the country are: (1) to insure their conservation for Filipino posterity; (2) to serve as an instrument of national defense, helping prevent the extension into the country of foreign control through peaceful economic penetration; and (3) to prevent making the Philippines a source of international conflicts with the consequent danger to its internal security and independence."[51]

Article XIII on the conservation and utilization of natural resources was a source of much heated interpellation at the Constitutional Convention. The delegates were highly cognizant of its importance --

> It should be emphatically stated that the provisions of our constitution which limit to Filipinos the rights to develop the natural resources and to operate the public utilities of the Philippines is one of the bulwarks of our national integrity. The Filipino people decided to include it in our Constitution in order that it may have the stability and permanency that its importance requires. It is written in our Constitution so that it may neither be the subject of barter nor be impaired in the give and take of politics. With our natural resources, our sources of power and energy, our public lands, and our public utilities, the material basis of the nation's existence, in the hands of aliens over whom the Philippine Government does not have complete control, the Filipinos may soon find themselves deprived of their patrimony and living as it were, in a house that no longer belongs to them.[52]

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[51]J. ARUEGO, *supra* note 43 at 604.

[52]This statement is attributed to the Honorable Vicente G. Sinco when he was serving his term as a delegate at the 1934 Constitutional Convention (Congressional Record, House of Representatives, Volume 1, No. 26, p. 561 cited in People v. Quasha, 46 SCRA 160, 170 (1972), hereinafter cited as the Quasha case). He was one of the foremost authority in constitutional law at the time. He subsequently became the Dean at the College of Law at the University of the Philippines and thereafter, its University President.

Two opposing views marked much of the debates that visited this issue at the 1934 Constitution Convention. At one extreme were the ultra-nationalists like Delegates Montilla and Gullas who advocated for 100% nationalization --

> *Delegate Montilla* -- The constitutional precepts that I believe will ultimately lead us to our desired goal are: (1) the complete nationalization of our lands and natural resources; (2) the nationalization of our commerce and industry compatible with good international practices. With the complete nationalization of our lands and natural resources it is to be understood that our God-given birthright should be one hundred per cent in Filipino hands... Lands and natural resources are immovable and as such can be compared to the vital organs of a person's body, the lack of possession of which may cause instant death or the shortening of life. If we do not completely nationalize these two of our most important belongings, I am afraid that the time will come when we shall be sorry for the time we were born. Our independence will be just a mockery, for what kind of independence are we going to have if a part of our country is not in our hands but in those of foreigners?[53]

> *Delegate Gullas*[54] -- Mr. President and fellow Delegates: ...It has been said here that we need foreign capital to exploit the natural resources of our country. Very well. We have also been impressed by the argument that we cannot afford to incur the enmity, the resentment, of the foreign powers at this time. Well and good. But Mr. President, *between the good will of foreign powers and the future security of our people, we have no choice.* Our pathway is clear... I remember now that President Quezon once said that *we must exploit the resources of the country but that we should do so with an eye only to the welfare of the future generations. In other words, the leaders of today are the trustees of the patrimony of our race. We should be nationalist...* What we now seek to do is to *prevent both combination and manipulation.* In the past, there have been officials and non- officials, big and small, used as tools by foreign capitalists in the Philippine Islands. That can happen again in

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authority in constitutional law at the time. He subsequently became the Dean at the College of Law at the University of the Philippines and thereafter, its University President.

[53]ARUEGO, *supra* note 43 at 592.

[54]Initially, the Committee on Nationalization had fixed 75% as the minimum Filipino equity participation in any corporation or association engaged in the disposition, exploitation, development or utilization of Philippine natural resources. Before submitting the draft for interpellation at the Constitutional Convention level, the Sub-Committee of Seven of the Sponsorship Committee reduced this to 60%. In effect, the latter increased the allowable foreign equity participation to 40%. In response to this reduction, Delegate Gullas proposed an amendment to bring the percentage back to 75% (hereinafter cited as the Gullas amendment). (J. ARUEGO, *supra* note 43, at 252 to 287.

> the future. That is why we wish to raise the percentage to seventy-five instead of sixty percent.
>
> I ask you to raise the standards not because we are hostile to foreign capitalists but because, as I said, we should provide for the welfare of our future.[55]

On the other camp were realists like Delegates Orense and Roxas who argued that foreign capital should not be entirely excluded as this would mean the suspension of the development of natural resources in the Philippines:

> *Delegate Orense* -- Mr. President and Gentlemen of the Convention: I have been few times on the side of the Sub- Committee; but this time I am with the Committee, because the provision of the draft limiting to 60% Filipino capital in undertakings dedicated to the exploitation of our natural resources appears to me very *wise, practical and reasonable. If we are going to increase to 75% native capital then we shall be giving not more than 25% to foreign capital. 25% in an enterprise for the exploitation of our big natural resources is like a drop of water in the midst of the ocean; it will not solve any problem.*
>
> In my experience during the few years in which I have been interested in some enterprises, I have seen that native capital has never been sufficient for the exploitation and for the success of business. Generally, their enterprises have gone to bankruptcy, have disappeared in the end of several months or years. The true end of this provision -- and in this the intention of those who spoke about principles in constitutional matters -- is to give the majority or, better said, the control to Filipinos in a corporation, so that those who manage and direct, as the majority here directs, be in purely Filipino hands. But we do not have to be so exclusivistic; I would say that we should not, not even reach the limit between nationalism and boxerism, because the adoption of 75% would be an indirect measure for excluding foreign capital. The retirement of foreign capital would signify for us the suspension of the development of our resources, and this would affect greatly the credit of the nation, and without this credit neither commerce nor industry is possible. Thank you.[56]
>
> *Delegate Roxas*: Mr. President, this is a matter which we believe the Assembly should resolve because the Members of the Committee are not in agreement on the question, and only I can express my personal opinion and it is the following: I believe that our purpose is not to allow aliens to control these activities, which are so important for our economic and political development.

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[55] J. ARUEGO, *supra* note 43, at 272-274; emphasis supplied.
[56] *Id.*, at 274-275; emphasis supplied.

> On the other hand, we should not close the doors to the help from outside in the form of capital which we shall need for the exploitation of our natural resources. Accordingly, when fixing a certain percentage as a minimum Filipino capital we should fix it in such percentage which in our concept would assure control of these corporations by Filipinos. To go further would be to impede the investment of foreign capital in the Philippines to help us in the development of our natural resources.
>
> I believe that the 51% which we approved in relation to public utility services is not sufficient. The 60%, however, I believe will place in Filipino hands effective control of these corporations. When fixing 75%, what we are really doing is not to fortify control but impede the investment of foreign capital in the Philippines for the development of our natural resources.[57]

When finally put to a vote, the Gullas amendment was defeated with 79 against and 41 in favor.[58] Thus, foreign equity participation under the 1935 Constitution was allowed to reach a maximum of 40% in any corporation or association engaged in the disposition, exploitation, development or utilization of natural resources. This notwithstanding, the underlying spirit of these provisions was never left in doubt – the delegates believed that at all costs, the natural resource wealth of the Philippines should be conserved for future generations of Filipinos as their rightful patrimony.[59] Effective control by Filipinos of entities engaged in the exploitation of natural resources is a *sine qua non* cost that foreigners have to shoulder in order for the latter to gain a foothold into the natural resource industry in the Philippines.

Inspired by a strong sense of resource nationalism, the 1934 Constitutional Convention delegates went for the abolishment of the perpetual freehold system[60] and the adoption of the leasehold system:[61]

> *Delegate Ventura.* -- ... Mineral lands should not be left in the hands of vast mining companies. They should be left to future generations to

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[57]*Id.*, at 271; emphasis supplied.

[58]*Id.*, at 279.

[59]Bautista, Issues on Nationalization of Certain Traditional Areas of Investments, 61 PHIL. L. J. 390, 391 (1986). The author, the Honorable Lilia R. Bautista, was occupying the following positions at the time of the writing: Governor, Board of Investments; Assistant Secretary, Ministry of Trade and Industry; Vice Chairman and Acting Executive director, Technology Transfer Board.

[60]*See* discussions, *supra*.

[61]CONST. (1935), art. XIII, sec. 1.

> develop. If the system of disposing of them is only the leasehold system for twenty-five years, renewable for another twenty-five years, we shall have a chance to further develop these mining claims after they are abandoned by the mining companies. The abandoned milling sites should be used for agricultural purposes and reforestation.[62]

Unlike the freehold system which was perpetual in character, the leasehold system limited the term within which a concessionaire is allowed to exploit the natural resource applied for. *Ipso facto* the leasehold system tends to accelerate mine development since it discourages idle mineral landholding.

Less than a decade after the 1935 Constitution became effective (May 14, 1935), World War II broke out. "The 1935 Constitution ceased to operate during the Japanese occupation from 1942 to 1944. It automatically became effective upon the reestablishment of the commonwealth government on February 27, 1945."[63]

"From the Japanese occupation and the reconquest of the Archipelago, the Philippine nation emerged with its industries destroyed and its economy dislocated."[64] Justice Fernando's graphic account described it best in *Commissioner of Internal Revenue v. Guerrero*:[65]

> It was fortunate that the Japanese Occupation ended when it did. Liberation was hailed by all, but the problems faced by the legitimate government were awesome in their immensity. The Philippine treasury was bankrupt and her economy prostrate. There were no dollar-earning export crops to speak of; commercial operations were paralyzed; and her industries were unable to produce with mills, factories and plants either destroyed or their machineries obsolete or dismantled. It was a desolate and tragic sight that greeted the victorious American and Filipino troops. Manila, particularly that portion south of the Pasig, lay in ruins, its public edifices and business buildings lying in a heap of rubble and numberless houses razed to the ground. It was in fact, next to Warsaw, the most devastated city in the expert opinion of the then General Eisenhower. There was thus a clear need of help from the United States. *American aid was forthcoming but on terms proposed by her government* and later on accepted by the Philippines.[66]

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[62]J. ARUEGO, *supra* note 43, at 268.

[63]H. S. DE LEON, *supra* note 50, at 32.

[64]Republic v. Quasha, 46 SCRA 160, 165 (1972).

[65]21 SCRA 181, 187 (1967); emphasis supplied.

[66]This description was confirmed by the 1945 Report of the Committee on Territories and Insular Affairs to the United States Congress:

In brief, the Philippines was in shambles after participating in a war it felt morally compelled to join because of its loyalty to the Americans. It was at this critical stage that the United States granted independence to the Philippines. American aid came but not without first exacting a price from the Philippines in what became known as the Parity Amendment to the 1935 Constitution. A faithful account of this whole process was described by Justice J. B. L. Reyes in the *Republic v. Quasha*:[67]

> ...in 1946, the United States 79th Congress enacted Public Law 3721, known as the Philippine Trade Act, authorizing the President of the United States to enter into an Executive Agreement with the President of the Philippines, which should contain a provision that --
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> 'The disposition, exploitation, development, and utilization of all agricultural, timber, and mineral lands of the public domain, waters, minerals, coal, petroleum, and other mineral oils,; all forces and sources of potential energy, and other natural resources of the Philippines, and the operation of public utilities shall, if open to any person, be open to citizens of the United States and to all forms of business enterprise owned or controlled, directly or indirectly, by United States citizens.'
>
> and that:
>
> 'The President of the United States is not authorized -- to enter into such executive agreement unless in the agreement the Government of the Philippines -- will promptly take such steps as are necessary to secure the amendment of the Constitution of the Philippines so as to permit the taking effect as laws of the Philippines of such part of the

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When the Philippines do become independent next July, they will start on the road to independence with a country whose commerce, trade and political institutions have been very, very seriously damaged. Years of rebuilding are necessary before the former physical conditions of the islands can be restored. Factories, homes, government and commercial buildings, roads, bridges, docks, harbors and the like are in need of complete reconstruction or widespread repairs. It will be quite some while before the Philippines can produce sufficient food with which to sustain themselves.

The internal revenues of the country have been greatly diminished by war. Much of the assessable property basis has been destroyed. Foreign trade has vanished. Internal commerce is but a fraction of what it used to be. Machinery, farming, implements, ships, bus and truck lines, inter island transportation and communications have been wrecked.'"[cited in Republic v. Quasha, 46 SCRA 160, 165-166 (1972)].

[67] *Id.*, at 166-167; emphasis supplied.

provisions of section 1331 -- as is in conflict with such Constitution before such amendment.'

The Philippine Congress, by Commonwealth Act No. 733, authorized the President of the Philippines to enter into the Executive Agreement. Said Act provided, inter alia, the following:

ARTICLE VII

1. The disposition, exploitation, development, and utilization of all agricultural, timber, and mineral lands of the public domain, waters, mineral, coal, petroleum, and other mineral oils, all forces and sources of potential energy, and other natural resources of the Philippines, and the operation of public utilities, shall, if open to any person, be open to citizens of the United States and to all forms of business enterprise owned or controlled, directly or indirectly, by United States citizens, except that (for the period prior to the amendment of the Constitution of the Philippines referred to in Paragraph 2 of this Article) the Philippines shall not be required to comply with such part of the foregoing provisions of this sentence as are in conflict with such Constitution.

2. *The Government of the Philippines will promptly take such steps as are necessary to secure the amendment of the Constitution of the Philippines so as to permit the taking effect as laws of the Philippines of such part of the provisions of Paragraph 1 of this Article as is in conflict with such Constitution before such amendments.*

Thus authorized, the Executive Agreement was signed on 4 July 1946, and shortly thereafter the President of the Philippines recommended to the Philippine Congress the approval of a resolution proposing amendments to the Philippine Constitution pursuant to the Executive Agreement. Approved by the Congress in joint session, the proposed amendment was submitted to a plebiscite and was ratified in November of 1946. Generally known as the Parity amendment, it was in the form of an Ordinance appended to the Philippine Constitution.

The Parity Amendment[68] reads as follows:

Notwithstanding the provisions of section one, Article Thirteen, and section eight, Article Fourteen, of the foregoing constitution, during

[68]Hereinafter referred to as the Parity Amendment. This was qualified in 1954 by the Laurel-Langley Agreement between the United States and the Philippines. Thereunder, the rights provided for under the Parity Amendment may be exercised "only through the medium of a corporation organized under the laws of the Philippines and at least 60% of the capital stock of which is owned or controlled by citizens of the United States." [*See* Palting v. San Jose Petroleum, Inc., 18 SCRA 924, 935 (1966)].

> the effectivity of the Executive Agreement entered into by the President of the Philippines with the President of the United States on the fourth of July, nineteen hundred and forty-six, pursuant to the provisions of Commonwealth Act Numbered Seven Hundred and thirty-three, but in no case to extend beyond the third of July, nineteen hundred and seventy-four, the disposition, exploitation, development, and utilization of all agricultural, timber, and mineral lands of the public domain, waters, minerals, coals, petroleum, and other mineral oils, all forces and sources of potential energy, and other natural resources of the Philippines, and the operation of public utilities, shall, if open to any person, be open to citizens of the United States and to all forms of business enterprise owned or controlled, directly or indirectly, by citizens of the United States in the same manner as to, and under the same conditions imposed upon, citizens of the Philippies or corporations or associations owned or controlled by citizens of the Philippines.

The Republic of the Philippines was inaugurated on July 4, 1946[69] and the Parity Amendment was ratified in November, 1946.[70] Ipso jure from July 4, 1946 to July 3, 1974, a period of 28 years, the privilege to acquire and exploit the natural resource wealth of the Philippines was extended to "citizens of the United States and to all forms of business enterprise owned or controlled, directly or indirectly, by citizens of the United States in the same manner as to, and under the same conditions imposed upon citizens of the Philippines or corporations or associations owned or controlled by citizens of the Philippines."[71]

(2) The 1973 Philippine Constitution

Like other parts of the world in the late 60s and early 70s, the Philippines at that time witnessed a clamor for radical changes, especially from its youth. Student activism was on the rise. Many a time, youth excesses and passions culminated in violence. It was a tie for a critical rethinking of set thought patterns and ideologies inherited from past colonial masters. Social, political and economic reforms, being in essense, "makabayan" (literally, pro-country or for the good of the nation) were the battle cries on the streets.

> (T)he Filipino people realized that their basic law needed overhauling if it was to remain responsive to the people's needs. Indeed, it had been

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[69]*See* De Leon, *supra* note 50, at 32.
[70]Republic v. Quasha, 46 SCRA 160, 173 (1972).
[71]*See* Parity Amendment, *supra* note 68.

vulnerable to such criticisms as "colonial," "outmoded," "overcentralized," "devoid of social and economic rights," and others:

(a) Taking into account the "felt necessities of the times" particularly the new and grave problems arising from an ever-increasing population, urgently pressing for solution, Congress in joint session on March 16, 1967, passed Resolution of Both Houses No.2 (as amended by Resolution No. 4, passed on June 17, 1969), authorizing the holding of a constitutional convention in 1971.

(b) On August 24, 1970, Republic Act No. 6132 was approved setting November 10, 1970, as election day for 320 delegates to the Constitutional Convention. The convention started its work of rewriting the Constitution on June 1, 1971. ...After 15 months, on its 291st plenary session on November 29, 1972, the convention approved the new proposed charter of the land. The vote was 273 in favor, 15 against, 27 absent. One refused to vote.[72] There were no abstentions. The proposed Constitution was signed the following day, November 30, 1972.

(c) Earlier on September 21, 1972, the President of the Philippines issued Proclamation No. 1081 placing the entire country under martial law. `To broaden the base of citizens' participation in the democratic process, and to afford ample opportunities for the citizenry to express their views on important matters of local or national concern,' Presidential Decree No. 86 was issued on December 31, 1972 creating a Citizens Assembly in each barrio in municipalities and in each district in chartered cities throughout the country. Subsequently, Presidential Decree No. 86-A was issued on January 5, 1973 defining the role of barangays (formerly Citizens Assemblies). It provides that the barangays created under Presidential Decree No. 86 `shall constitute the base for citizens' participation in governmental affairs and their collective views shall be considered in the formulation of national policies or programs and, whenever practicable, shall be translated into concrete and specific decisions.'

(d) Under the same decree, the barangays were to conduct a referendum on national issues between January 10 and 15, 1973. Pursuant to Presidential Decree No. 86-A, the following questions were submitted before the Citizens Assemblies or Barangays:

1) Do you approve of the New Constitution?; and

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[72]The suspicion has always remained that during the early months of martial law, a substantial number of provisions had been inserted by President Marcos in this Constitution.

> 2) Do you still want a plebiscite to be called to ratify the new constitution?
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> (e) According to Proclamation No. 1102 issued on January 17, 1973, 14,976,561 members of all the Barangays (Citizens Assemblies) voted for the adoption of the proposed Constitution, as against 743,869 who voted for its rejection. On the question as to whether or not the people would still like a plebiscite to be called to ratify the new Constitution, 14,298,814 answered that there was no need for a plebiscite.
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> (f) On the basis of the above results purportedly showing that more than 95% of the members of the Barangays (Citizens Assemblies) were in favor of the new Constitution and upon the "strong recommendation" of the Katipunan ng mga Barangay (Organization of Barangays), the President of the Philippines through Proclamation No. 1102 on January 17, 1973 certified and proclaimed that the constitution proposed by the 1971 Constitutional convention had been ratified by the Filipino people and had thereby come into effect.[73]

Regarding foreign equity participation in the exploitation of Philippine natural resources, Section 9, Article XIV of the 1973 Constitution provides that:

> The disposition, exploration, development, exploitation, or utilization of any of the natural resources of the Philippines shall be limited to citizens of the Philippines, or to corporations or associations at least sixty per centum of the capital of which is owned by such citizens. The National Assembly, in the national interest, may allow such citizens, corporations or associations to enter into service contracts for financial, technical, management, or other forms of assistance with any foreign person or entity for the exploration, development, exploitation, or utilization of any of the natural resources. Existing valid and binding service contracts for financial, technical, management, or other forms of assistance are hereby recognized as such.[74]

Insofar as maximum foreign equity participation being limited to 40% is concerned, the 1973 Constitution merely reiterated the analogous provision in the 1935 Constitution. The significant change under the 1973 Constitution was its explicit recognition of the legality of service contracts with foreign entities as not being violative of constitutional precepts. It

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[73]Javellana v. Executive Secretary, 50 SCRA 30 (1973).

[74]Emphasis and italics indicating substantial changes supplied.

laid to rest doubts previously entertained regarding the constitutionality of these arrangements.

With respect to the service contract arrangement, the delegates drew inspiration from the successful utilization of such arrangements in India, Pakistan and especially Indonesia in the area of petroleum and mineral oil exploration.[75] This, notwithstanding, it is interesting to note that the service contract arrangement, irrespective of its inherent merits, has always been viewed with suspicion. Considering the date on which this subject was taken up (November 25, 1972) on the floor of the Constitutional Convention, i.e., a few days before the approval of the entire proposed charter and two months after martial law was declared, the "service contract" arrangement was treated with suspect as of those midnight provisions forced on the constitutional convention by President Marcos. In the years to come, its defenders have considered this experimental concept to have proven itself to be "an effective institution in the development of energy resources in the Philippines", "a truly reliable vehicle by which the Government may be able to carry out the country's indigenous energy development program towards an energy-reliant future."[76] Its perceived advantages were cited as follows:

> This system typically frees the host state from any financial burden in connection with operations. It allows the State participation in the control of petroleum operations and ensure that the State will be allocated as agreed upon a minimum share of production, irrespective of the exploratory and development costs of the oil company.[77]

On the other hand, its detractors considered the service contract arrangement under the 1973 Constitution to have "legalized dummyism in

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[75]*See* J. G. BERNAS, THE CONSTITUTION OF THE REPUBLIC OF THE PHILIPPINES: A COMMENTARY 425 n. 26 (1988) who attributed this explanation to Delegate Valera of the 1971 Constitutional Convention. The original idea behind this provision was to authorize the government, not private entities, to enter into service contracts with foreign entities. As finally approved, however, a citizen or private entity could be allowed by the National Assembly to enter into such service contract. The prior approval of the National Assembly was deemed sufficient to protect the national interest. Session of November 25, 1972.

[76]Dimagiba, Service Contract Concepts in Energy, 57 PHIL. L. J. 307, 331 (1982).

[77]*Id.*, at 316 citing FABRIKANT, OIL DISCOVERY AND TECHNICAL CHANGE IN SOUTHEAST ASIA, LEGAL ASPECTS OF PRODUCTION SHARING CONTRACTS IN THE INDONESIAN PETROLEUM INDUSTRY 104 (1972).

natural resource exploitation",[78] a "means of circumventing the prohibitions of the Constitution",[79] *i.e.*, it renders illusory the constitutional ideal to keep the nation's natural resource wealth within the effective control of its citizens. These misgivings deepened when the Secretary of Justice ruled in 1977[80] that a service contractor, who at the same time is an investor to the extent of 40% in a Filipino corporation which owns the mining rights, is entitled to dividends for its 40% shareholding as well as to fees due it as a service contractor:

> While payments to a service contractor may be justified as a service fee, and therefore properly deductible from the gross proceeds of the corporation, the service contract could be employed as a means for going about or circumventing the constitutional limit on foreign equity participation and the obvious constitutional policy to insure that Filipinos retain beneficial ownership of our mineral resources. To determine the reasonableness of the total "service fee", the following must be looked into: the valuation of services rendered, accounting of funds advanced, and most importantly, the manner of computing the "proceeds of operation" and the duration of the sharing in the said proceeds in relation to the exposure of the foreign contractor, *i.e.*, the nature and extent of the risks assumed by the contractor, the magnitude of capital investment, and other relevant considerations like the options available to the contractor to become equity participant in the Philippine entity holding the concession, or to acquire rights in the processing and marketing stages.[81]

Thus, "where services in a service contract are properly valued, they should normally be deductible as expenses of operations, and consequently should not affect the 60-40 sharing between the Filipino and alien stockholders, respectively. In other words, bona-fide service fees and returns from equity contributions are not to be added together for the purpose of determining compliance with the Constitutional limitation."[82] In a belated response in November, 1979, the Cabinet Standing Committee issued the following directive to curb further abuses made of the service contract as a tool for circumventing the 60%-40% rule:

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[78]M. Magallona, Nationalism and the New Constitution, cited in Commissioner Gascon's interpellation, III RECORDS OF THE CONSTITUTIONAL COMMISSION 321, Session of August 14, 1986.

[79]J. G. BERNAS, *supra* note 75, at 426.

[80]Secretary of Justice Opinion No. 144 (s. 1977) *cited* in Bautista, *supra* note 59, at 392-393.

[81]*Id.*, at 383.

[82]*Id*; emphasis supplied.

> that the maximum service contract fee is 40% before tax; since the basic idea of service contracts was instituted to develop mineral and other natural resources in the Philippines which either the government or other business could not develop in the meantime, it must be observed, however, that the constitutional limitation as to sharing of benefits is limited to 40%. In the case of foreign equity holders, the return on equity is taxed and therefore the mining service contract fee which could go up to a ceiling of 40% should be treated on parallel basis, and should be considered as pre-tax, without prejudice to the unpacking of certain fees which are compensable directly to other foreign companies.[83]
>
> With the above rule the concerns of those who fear(ed) that service contracts are a circumvention of the Constitutional restriction (were) partly resolved. There is still the need, however, to scrutinize each cost item deducted by the contractor from the cost proceeds to determine whether indeed the beneficial gain is principally to the Filipinos.[84]

Aside from highlighting the legality of the "service contract" arrangement, the 1973 Constitution evidenced a new awareness for the environmental ramifications of natural resource projects:

> The National Assembly, *taking into account conservation, ecological, and development requirements of the natural resources,* shall determine by law the size of lands of the public domain which may be developed, held or acquired by, or leased to, any qualified individual, corporation, or association, and the conditions therefor. No private corporation or association may hold alienable lands of the public domain except by lease not to exceed 1,000 hectares in area; nor may any citizen hold such lands by lease in excess of 500 hectares or acquire by purchase or homestead in excess of 24 hectares. No private corporation or association may hold by lease, concession, license, or permit, timber or forest lands and other timber or forest resources in excess of 100,000 hectares; however, such area may be increased by the National Assembly upon recommendation of the National Economic and Development Authority.[85]

On the whole, however, the framework adopted under the 1935 Constitution was kept intact. More particularly, the limited leasehold system under the 1935 Constitution was retained:

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[83]*Id.*, at 394.
[84]*Id.*
[85]CONST. (1973), art. XIV, Sec. 11; emphasis supplied.

> All lands of the public domain, waters, minerals, coal, petroleum and other mineral oils, all forces of potential energy, fisheries, wildlife, and other natural resources of the Philippines belong to the State. With the exception of agricultural, industrial or commercial, residential, and resettlement lands of the public domain, natural resources shall not be alienated, and no license, concession, or lease for the exploration, development, exploitation, or utilization of any of the natural resources shall be granted for a period exceeding twenty-five years, renewable for not more than twenty-five years, except as to water rights for irrigation, water supply, fisheries, or industrial uses other than the development of water power, in which cases, beneficial use may be the measure and the limit of the grant.[86]

(3) The 1987 Philippine Constitution

On August 21, 1983, Marcos oppositionist, former Senator Benigno Aquino, returning to the Philippines after his three-year self-exile in the United States, was assassinated at the tarmac of the Manila International Airport. The blatant atrocity of the act set in motion a chain of events that altered Philippine history for all times. Because of Aquino's single act of faith and courage, millions of Filipinos, from all walks of life, decided to come out of their generally apathetic and lethargic pose, and fight for change. In less than three years, Aquino's widow, Mrs. Corazon C. Aquino was catapulted into power through what is now known in world history as the miraculously peaceful EDSA/People's Revolution of February, 1986. More particularly, Mrs. Aquino assumed power on February 25, 1986 in the midst of a popular and military uprising sparked by fraudulent elections.[87] A month later, President Aquino issued Proclamation No. 3 which promulgated the Provisional or Freedom Constitution and created the Constitutional Commission.[88] The Constitutional Commission was made up of Aquino appointees and was tasked with the drafting of the 1987 Constitution. On the night of October 12, 1986, the Commission completed its job, culminating 133 days of work, with 45 members voting in its favor and one against.[89] The 1987 Constitution was ratified by 81% of the voters in a national plebiscite held on February 2, 1987.[90]

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[86]CONST. (1973), art. XIV, sec. 8; emphasis supplied.

[87]Country Profile: Philippines, KCWD (c) 1991 ABC-Clio, Inc. (NEXIS: Load: April 24, 1991).

[88]H.S. DE LEON, *supra* note 50, at 37.

[89]*Id.*, at 39.

[90]*Id.*; See also Country Profile: Philippines, KCWD (c) 1991 ABC-Clio, Inc. (NEXIS: Load: April 24, 1991).

In line with its rather lengthy style, the 1987 Constitution contains the following parallel provision with respect to limitations placed on foreign equity participation in the exploitation of Philippine natural resources:

> All lands of the public domain, waters, minerals, coal, petroleum, and other mineral oils, all forces of potential energy, fisheries, forests or timber, wildlife, flora and fauna, and other natural resources are owned by the State. With the exception of agricultural lands, all other natural resources shall not be alienated. The exploration, development, and utilization of natural resources shall be under the full control and supervision of the State. The State may directly undertake such activities, or it may enter into co-production, joint venture, or production-sharing agreements with Filipino citizens, or corporations or associations at least sixty per centum of whose capital is owned by such citizens. Such agreements may be for a period not exceeding twenty-five years, renewable for not more than twenty-five years, and under such terms and conditions as may be provided by law. In cases of water rights for irrigation, water supply, fisheries, or industrial uses other than the development of water power, beneficial use may be the measure and limit of the grant.

The State shall protect the nation's marine wealth in its archipelagic waters, territorial sea, and exclusive economic zone, and reserve its use and enjoyment exclusively to Filipino citizens.

The Congress may, by law, allow small-scale utilization of natural resources by Filipino citizens, as well as cooperative fish farming, with priority to subsistence fishermen and fishworkers in rivers, lakes, bays, and lagoons.

The President may enter into agreements with foreign-owned corporations involving either technical or financial assistance for large-scale exploration, development, and utilization of minerals, petroleum, and other mineral oils according to the general terms and conditions provided by law, based on real contributions to the economic growth and general welfare of the country. In such agreements, the State shall promote the development and use of local scientific and technical resources.

The President shall notify the Congress of every contract entered into in accordance with this provision, within thirty days from its execution.[91]

Article XII (National Economy and Patrimony) of the 1987 Constitution is part of an overall vision to effectuate efficiency and equity with respect to the management of the Philippine economy:

> *Mr. Monsod* - The whole economy is concerned principally with two things: efficiency and equity, that is, creation of wealth and distribution of wealth. In both the Articles on National Economy and Social Justice, we are trying to strike a balance -- the demands for equity and distribution are primarily in the Article on Social Justice and the requirements for efficiency and productivity and wealth creation are in the Article on National Economy and Patrimony. Even then, we will notice that the Article on National Economy and Patrimony is permeated with the social aspect. So, if we look at both articles, there is a very strong emphasis on the social aspect of production, distribution and the activities within the economy.[92]
>
> The process towards the attainment of efficiency and productivity in wealth creation is not, however, to be made at the sacrifice of "economic sovereignty" or "economic nationalism"[93]
>
> *Mr. Garcia* - ...Filipino control of our economy -- The principle of economic sovereignty must underlie all efforts towards self-reliance and the full development of our nation's productive forces. This means, first of all, that the entry of foreign capital, technology and business enterprises into the national economy shall be effectively regulated to insure the protection of the interest of our people.[94]

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[91]CONST. (1987), art. XII, sec. 2, emphasis supplied; italics indicating substantial changes added.

[92]III RECORDS OF THE CONSTITUTIONAL COMMISSION 274, Session of August 13, 1986.

[93]III RECORDS OF THE CONSTITUTIONAL COMMISSION 318, Session of August 14, 1986.

[94]III RECORDS OF THE CONSTITUTIONAL COMMISSION 306, Session of August 14, 1986. A day earlier, Commissioner Villegas at his sponsorship speech on the article on National Economy and Patrimony had elucidated on the Committee's concept of "economic self-reliance":

`Economic self-reliance' is a primary objective of a developing country that is keenly aware of overdependence on external assistance for even its most basic needs. It does not mean autarky or economic reclusion; rather, it means avoiding mendicancy in the international economic community. Independence refers to the freedom from undue foreign control of the national economy, especially in such strategic industries as in the

The Commissioners feared that "foreign investors will use their enormous capital resources to facilitate the actual exploitation or exploration, development and effective disposition of (Philippine) natural resources to the detriment of Filipino investors."[95] At the same time, the Commissioners were well aware that the Philippine economy (specially the mining industry) is sadly deficient in risk capital:

> *Mr. Villegas* - During the public hearings, we heard people from the mining and oil exploration industries, who presented a very strong case, that foreign investment is actually indispensable because there is no risk capital available in the Philippines. If the Gentleman will remember, the figure cited over the last ten years is that P 800 million (approximately US$ 30 million in today's terms) literally went down the drain in oil exploration and up to now, no oil has been found, and all that money was foreign money. These people asked a rhetorical question: Can you imagine if that money belonged to Filipinos?[96]

Hence, the need to attract foreign capital or financial assistance was also uppermost on the delegates' minds.[97] To strike a balance between these two apparently diametrically opposed goals, the Commissioners adopted (1) the 60%-40% rule (vintage 1935 and 1973 Constitutions) and (2) a more restricted "service contract" arrangement.

As with the 1934 Constitutional Convention interpellation, deliberations by members of the 1986 Constitutional Commission on the upper limit of foreign equity participation in Philippine natural resource exploitation were fiercely passionate. On one hand were Commissioners Davide, Garcia, Gascon and Azcuna who argued vociferously for 100% Filipino capital:

> *Mr. Davide* - The Commission had just approved the Preamble. 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,

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development of natural resources and public utilities." (III RECORDS OF THE CONSTITUTIONAL COMMISSION 252, Session of August 13, 1986; emphasis added).

[95]Part of Commissioner Quesada's interpellation, *Id.*, at 316.

[96]*Id.*, at 310; parenthetical remark supplied.

[97]*See* Commissioner Villegas' remarks in III RECORDS OF THE CONSTITUTIONAL COMMISSION 266, 321, respectively, Sessions of August 13 & 14, 1986.

> 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.
>
> I voted in favor of the Jamir proposal because it is not really exploitation that we granted to the alien corporations but only for them to render financial or technical assistance. It is not for them to enjoy our natural resources. Madam President, our natural resources are depleting; our population is increasing by leaps and bounds. fifty years from now, if we will allow these aliens to exploit our natural resources, there will be no more natural resources for the next generations of Filipinos. It may last long if we will begin now. Since 1935 the aliens have been allowed to enjoy to a certain extent the exploitation of our natural resources, and we became victims of foreign dominance and control. The aliens are interested in coming to the Philippines because they would like to enjoy the bounty of nature exclusively intended for the Filipinos by God.
>
> And so I appeal to all, for the sake of the future generations, that if we have to pray in the Preamble "to preserve and develop the national patrimony for the sovereign Filipino people and for the generations to come," we must at this time decide once and for all that our natural resources must be reserved only to Filipino citizens.[98]

On the other camp were pragmatists in the persons of Commissioners Villegas, Padilla and Romulo who argued that to require more than 60% minimum Filipino capital would effectively scare away foreign capital:

> *Mr. Villegas* - This matter of ownership has been fully discussed in the Committee with all the public hearings possible and the conclusion that 60-percent Filipino ownership is a sufficient guarantee that the national welfare is going to be preserved. Secondly, when we talk about shortage of domestic capital, this is most acute in the exploration and development of natural resources because it is in these activities that there is very high risk, especially in oil exploration. It would prejudice not only the people who are not going to be employed by these types of corporations that would not be able to attract the necessary capital but it would also prevent the utilization of natural resources for the present generation in order to help them develop their talents and skills through education and other development programs.[99]

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[98]III RECORDS OF THE CONSTITUTIONAL COMMISSION 359, Session of August 15, 1986.

[99]*Id.*

> *Mr. Padilla* - The Treñas amendment has already been approved. The only one left is the Davide amendment which is substituting the "sixty percent" to "WHOLLY owned by Filipinos.
>
> Madam President, I am against the proposed amendment of Commissioner Davide because that is an ideal situation where domestic capital is available for the exploration, development and utilization of these natural resources, especially minerals, petroleum and other mineral oils. These are not only risky business but they also involve substantial capital. Obviously, it is an ideal situation but it is not practical. And if we adopt the 100-percent capital of Filipino citizens, I am afraid that these natural resources, particularly these minerals and oil, et cetera, may remain hidden in our lands, or in other offshore places without anyone being able to explore, develop or utilize them. If it were possible to have a 100-percent Filipino capital, I would prefer that rather than the 60 percent, but if we adopt the 100 percent, my fear is that we will never be able to explore, develop and utilize our natural resources because we do not have the domestic resources for that.[100]

When it finally came down to a vote, the Davide amendment for 100% Filipino capital lost by a narrow margin (16 in favor, 22 against). When this occurred, Commissioner Davide pushed for another amendment that called for the exclusion of foreigners from the governing and managing boards of corporations or entities engaged in the exploitation of natural resources in the Philippines.[101] This proposal equally met with failure because of its fundamental unfairness (14 in favor, 20 against and 1 abstention).[102] Thereafter Commissioner Garcia took up the cudgels and proposed an amendment that would limit foreign equity participation to 25% instead of 40%.[103] This too did not succeed (16 in favor, 18 against and 1 abstention).[104] Finally, in a last-ditch attempt, Commissioner Suarez proposed one-third or 33 1/3% as the limit on foreign equity participation.[105] This also failed to garner the necessary votes (17 in favor, 20 against, no abstention).[106]

The victory of the realists must be taken in perspective. The 1987 Constitution has introduced a new framework for natural resource

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[100] *Id.*, at 361.
[101] *Id.*, at 362.
[102] *Id.*, at 363.
[103] *Id.*, at 364.
[104] *Id.*
[105] *Id.*
[106] *Id*, at 365.

exploitation. Section 2, Article XII of the 1987 Constitution requires the State to undertake the exploration, development and utilization of natural resources either directly or through co-production, joint venture or production sharing agreements with Filipino citizens or corporations or associations at least 60% of whose capital is owned by such citizens. The old system whereby the natural resources are explored by license or concession without any State participation is no longer permitted.[107] The exploration, development, and utilization of natural resources is to be under the full control and supervision of the State. Whereas before, the role of the government was merely to give the permission to explore, develop or utilize natural resources, Section 2 now requires it to take a more active role.[108] From the foreign investor's perspective, this might elicit mixed perceptions. To the extent that state participation results in a reduction of risk (through the provision of sovereign guarantee or easy access to inexpensive multilateral agency (*e.g.*, International Monetary Fund, Asian Development Bank) financing), state participation might be viewed as an incentive. However, to the extent that State participation entails costly bureaucracy or interference in mining operations, this might be viewed as an unpalatable entry cost or a disincentive.

The other variable on the balancing tightrope was the concept of a more limitative service contract arrangement or more properly, contracts for technical or financial assistance.[109] Attempts were not lacking among the Commissioners to have the provision taken out; failing this, to have stringent restrictions put on its use:

> *Mr. Nolledo* - Madam President, I was one of those who refused to sign the 1973 Constitution, and one of the reasons is that there were many provisions in the Transitory Provisions therein that favored aliens. I was shocked when I read a provision authorizing service contracts while we, in this Constitutional Commission provided for Filipino control of the economy. We are, therefore, providing for exceptional instances where aliens may circumvent Filipino control of our economy. And one

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[107]H.S. DE LEON, *supra* note 50, at 457.

[108]*Id.*

[109]The very term "service contract" was such an anathema, evoking images of how the past regime under Marcos had abused its use in order to circumvent the 60-40 rule, that the 1986 Constitutional Commissioners assiduously refrained from using the term in the 1987 Constitution. (*See* Commissioner Villegas' comment that "the deletion of the phrase `service contracts'" was a "first attempt to avoid some of the abuses in the past regime in the use of service contracts to go around the 60-40 arrangement" in III RECORDS OF THE CONSTITUTIONAL COMMISSION 278, Session of August 13, 1986).

> way of circumventing the rule in favor of Filipino control of the economy is to recognize service contracts.
>
> As far as I am concerned, if I should have my own way, I am for the complete deletion of this provision. However, we are presenting a compromise in the sense that we are requiring a two- thirds vote of all the Members of Congress as a safeguard. I think we should not mistrust the future Members of Congress by saying that the purpose of this provision is to avoid corruption. We cannot claim that they are less patriotic than we are. I think the Members of this Commission should know that entering into service contracts is an exception to the rule on protection of natural resources for the interest of the nation and, therefore, being an exception it should be subject, whenever possible, to stringent rules. It seems to me that we are liberalizing the rules in favor of aliens.
>
> I say these things with a heavy heart, Madam President. I do not claim to be a nationalist, but I love my country. Although we need investments, we must adopt safeguards that are truly reflective of the sentiments of the people and not mere cosmetic safeguards.[110]

In contrast to the service contract arrangement under the 1973 Constitution, several safeguards[111] accompany the "service contract" arrangement under the 1987 Constitution, to wit: (1) the agreement must involve either technical or financial assistance; (2) it is allowed only with respect to large-scale (*i.e.*, capital intensive) activities;[112] (3) it must be for the exploration, development, and utilization of minerals, petroleum, and other mineral oils;[113] (4) the terms and conditions thereof must be according to the general guidelines promulgated by Congress (*i.e.*, by law), based on real contributions to the economic growth and general welfare of the country;[114] (5) the President must subsequently notify Congress of each

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[110]*Id.*, at 354, Session of August 15, 1986.

[111]Please refer back to the last two paragraphs of Section 2, Article XII of the 1987 Philippine Constitution on page of this work.

[112]III RECORDS OF THE CONSTITUTIONAL COMMISSION 255, Session of August 13, 1986; Under Executive Order No. 279, "large scale" has been defined as involving a committed capital investment of at least US$50 million in a single mining unit project (Section 4).

[113]These specific areas were cited as being in need of technical or financial assistance. The enumeration is exclusive. (*See* III RECORDS OF CONSTITUTIONAL COMMISSION 355, Session of August 15, 1986).

[114]*Id.*, at 348. The Secretary of Justice has ruled recently (Opinion No. 175 dated October 3, 1990, at 6) that pending the enactment by Congress of a more comprehensive law on the subject, the guidelines which shall govern the execution of contracts or agreements involving either technical or financial assistance for large scale exploration,

contract entered into within 30 days from its execution;[115] (6) the State shall promote the development and use of local scientific and technical resources in such agreement;[116] and (7) the project implementation shall be subject to the full control and supervision of the government.[117] One noted author opined:

> [Whereas] under the 1973 Constitution, exclusive management and control could be given to the foreign service contractor thereby legitimizing that which was prohibited by the 1935 Constitution - - the exploitation of the country's natural resources by foreign nationals. The new rule recognizes the need for foreign capital and technology to develop the natural resource wealth of the country but without sacrificing Philippine sovereignty and control over such resources since the foreign entity is just a pure contractor and not a beneficial owner thereof.[118]

> Finally, another interesting innovation under the 1987 Constitution is the special mention of small-scale utilization of natural resources, *e.g.*, small-scale coal or gold mining as well as cooperative fish farming. "This focus on small-scale natural resource utilization jibes with what can be considered a distinct flavor of the 1986 *(sic)* Constitution -- the preferential concern for the poor or the underprivileged."[119]

All in all, the 1987 Constitution had introduced very substantial changes in connection with the exploitation of natural resources in the Philippines. While it is hoped that the innovations introduced will really work out and achieve efficiency, equity and economic sovereignty for the

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development, and utilization of mineral resources are provided for in Executive Order No. 279.

[115]Commissioner Ople sponsored this amendment. He expressed the rationale behind this reporting requirement as follows:

Congress can always change the general law later on to conform to new perceptions of standards that should be built into service contracts. But the only way Congress can do this is if there were a notification requirement from the Office of the President that such service contracts had been entered into, subject then to the scrutiny of the Members of Congress. This pertains to a situation where the service contracts are already entered into, and all that this amendment seeks is the reporting requirement from the Office of the President."(Id., at 351).

[116]This condition would try to insure that technology is transferred so that dependence on foreign technology would not be unnecessarily prolonged.

[117]Secretary of Justice Opinion No. 175 dated October 3, 1990, at 5.

[118]H.S. DE LEON, *supra* note 50, at 460 citing the 1986 UPL (University of the Philippines Law Center's) Constitutional Project at 11.

[119]This was part of Commissioner Villegas' sponsorship speech in connection with Article XII on National Economy and Patrimony. (III RECORDS OF THE CONSTITUTIONAL COMMISSION 253, Session of August 13, 1986).

country as envisioned by the Constitutional Commission, only history en future can measure its success or failings.

IV. PERVASIVE JUDICIAL DOCTRINES AND ADMINISTRATIVE INTERPRETATIONS: THE CONTROL TEST V. THE GRANDFATHER RULE

In a span of little more than half a century, the Philippines has lived through three major constitutions. Common to all three constitutions was the formulation "sixty per centum of whose capital is owned by (Filipino) citizens" which set an upper limit of forty per centum for foreign equity participation in the exploration, development, and utilization of natural resources in the Philippines. While the 60%-40% guideline smarts of obvious simplicity, its implementation in operational terms has not been as fortunately blessed. While the constitutional underpinnings of the 60%-40% construct may guide one in understanding its policy goals, they are not complete. Aside from being a politically sensitive issue, the implementation of the 60%-40% rule had had to deal with the complexities of modern day corporate practices, more particularly, the phenomena of intercorporate holdings. In its barest terms, to what extent or how far do you trace ownership? When is a Filipino corporation Filipino enough? To grapple with this problem, certain judicial doctrines and administrative rules and interpretations have evolved over the last fifty years. More specifically, these are the "control test" and the "grandfather rule". In this title, the headwaters and meanderings of these legal yardsticks through Philippine legal history will be traced. The next title is an attempt to provide a policy analysis of the same.

(1) Judicial Doctrines: The Control Test v. The Grandfather Rule

During its colonial period under the United States (1898-1946), the Philippines had imbibed a lot of Anglo-American concepts into its commercial legal system. One such precept was the incorporation test, *i.e.*, the nationality of a corporation is that of its state of incorporation regardless of the nationality of its shareholders.[120] In 1951, however, the Philippine Supreme Court in the case of *Filipinas Cia De Seguros v.*

[120]3 A.F. AGBAYANI, COMMERCIAL LAWS OF THE PHILIPPINES 646 (1988).

Christern Huenefeld & Co., Inc.[121] pierced the corporate veil and adopted the "control test":

> *The nationality of the respondent corporation is to be determined by the nationality of its controlling stockholders.* 'There is no question that majority of the stockholders of the respondent corporation were German subjects. This being so, we have to rule that said respondent became an enemy corporation upon the outbreak of the war between the United States and Germany. ...The Philippine Insurance Law (Act No. 2427), as amended in section 8, provides that 'anyone except a public enemy may be insured.' It stands to reason that an insurance policy ceases to be allowable as soon as an insured becomes a public enemy.[122]

> Less than a year after, the Philippine Supreme Court reiterated the "control test" in *Davies Winship v. Phil. Trust Co.*[123] where it held that "as far as Japanese Military Administration was concerned, the 'nationality of a private corporation is determined by the character or citizenship of its controlling stockholders.' Consequently, where the controlling stockholders of a corporation were American citizens, said corporation came within the terms of an order requiring all deposit accounts of hostile people to be transferred to the Bank of Taiwan.[124]

In 1955, the Philippine Supreme Court, in the case of *Register of Deeds v. Ung Siu Si Temple*[125] applied the "control test" in interpreting the nationality provision in Section 1 of the 1935 Constitution:

> The purpose of the sixty *per centum* requirement is obviously to ensure that corporations or associations allowed to acquire agricultural land or to exploit natural resources shall be controlled by Filipinos; and the spirit of the Constitution demands that in the absence of capital stock, the *controlling membership* should be composed of Filipino citizens.[126]

On the other hand, the Court has yet to apply the "grandfather rule" as a legal yardstick to determine the nationality of a corporation. Under the grandfather rule, it is necessary to look beyond the corporate stockholder to the nationality of the natural stockholder of the holding company. This concept, however, has never been clearly defined in any case.

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[121]89 Phil. 54 (1951).

[122]A.F. AGBAYANI, *supra* note120, at 44 which provided an excerpt of Filipinas Cia De Seguros v. Christern Huenefeld & Co., Inc.

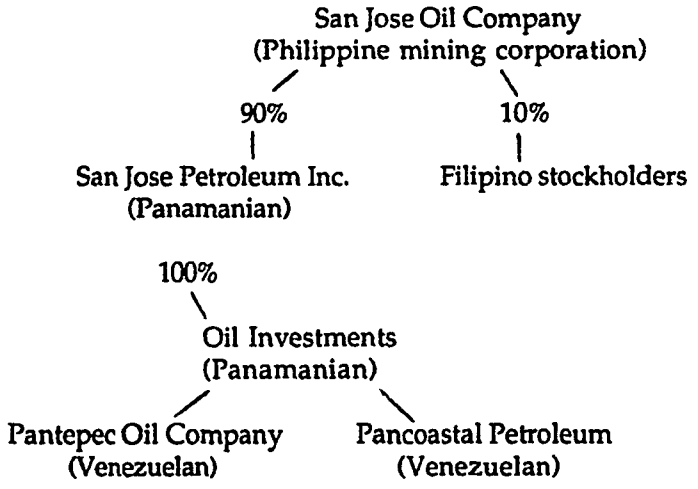
[123]90 Phil. 744 (1952).

[124]A.F. AGBAYANI, *supra* note 120, at 43.

[125]97 Phil. 58 (1955).

[126]Emphasis supplied.

Of relevant interest to the non-application of the "grandfather rule" by the Supreme Court is the case of *Palting v. San Jose Petroleum Inc.*[127] The *Palting* case involved the Parity Amendment as previously discussed. The issue presented to the Supreme Court for resolution was whether or not San Jose Petroleum, Inc., a Panamanian corporation which owned ninety percent (90%) of the capital stock of San Jose Oil Company, Inc. (a Philippine mining corporation) was an American business enterprise entitled to parity rights in the Philippines. In resolving the issue, the Supreme Court had to ascertain whether or not San Jose Petroleum, Inc. was owned or controlled, directly or indirectly, by American citizens because the parity rights to utilize, exploit and develop the natural resources of the Philippines (the business of the domestic subsidiary of San Jose Petroleum, Inc. – San Jose Oil Company, Inc.) could be extended only to citizens of the United States and business enterprises owned or controlled, directly or indirectly, by citizens of the United States. Schematically, the intercorporate structure follows:



[127]18 SCRA 924 (1966).

In resolving the issue against respondent, San Jose Petroleum, Inc., the Court ruled that:

> Firstly -- It is Philippine Supreme not owned or controlled directly by citizens of the United States, because it is owned and controlled by a corporation, the OIL INVESTMENTS, another foreign (Panamanian) corporation.
>
> Secondly -- Neither can it be said that it is indirectly owned and controlled by American citizens through the OIL INVESTMENTS, for this latter corporation is in turn owned and controlled, not by citizens of the United States, but still by two foreign (Venezuelan) corporations, the PANTEPEC OIL COMPANY and PANCOASTAL PETROLEUM.
>
> Thirdly -- Although it is claimed that these two last corporations are owned and controlled respectively by 12,373 and 9,979 stockholders residing in the different American states, there is no showing in the certification furnished by respondent that the stockholders of PANCOASTAL or those of them holding the controlling stock, are citizens of the United States.
>
> Fourthly -- Granting that these individual stockholders are American citizens, it is yet necessary to establish that the different states of which they are citizens, allow Filipino citizens or corporations or associations owned or controlled by Filipino citizens, to engage in the exploitation, etc. of the natural resources of these states (*see* paragraph 3, Article VI of the Laurel-Langley Agreement, *supra*). Respondent has presented no proof to this effect.
>
> Fifthly -- *But even if the requirements mentioned in the two immediately preceding paragraphs are satisfied, nevertheless to hold that the set-up disclosed in this case, with a long chain of intervening foreign corporations, comes within the purview of the Parity amendment regarding business enterprises indirectly owned or controlled by citizens of the United States is to unduly stretch and strain the language and intent of the law. For to what extent must the word "indirectly" be carried ? Must we trace the ownership or control of these various corporation ad infinitum for the purpose of determining whether the American ownership-control-requirement is satisfied ? Add to this the admitted fact that the shares of stock of the PANTEPEC and PANCOASTAL which are allegedly owned or controlled directly by citizens of the United States, are traded in the stock exchange in New York, and you have a situation where it becomes a practical impossibility to determine at any given time, the citizenship of the controlling stock required by the law.* In the circumstances, we have to hold that the respondent SAN JOSE PETROLEUM, as presently constituted, is not a business enterprise that is authorized to exercise the

> parity privileges under the Parity Ordinance, the Laurel-Langley Agreement and the Petroleum Law. Its tie-up with SAN JOSE OIL is, consequently, illegal.[128]

In effect, the Supreme Court in the Palting case categorically refused to go beyond the first layer of stock ownership in determining corporate nationality in relation to the application of the 60%-40% rule in natural resource exploitation under the 1935 Constitution and its amendment. It can be said that the Palting decision promulgated on December 17, 1966 contained the first judicial assertion that in relation to natural resource exploitation, juridical persons *per se* have a separate nationality (*i.e.*, there is a limit to tracing ownerships down the line to natural persons) and that the same is determined by applying the control test.

(2) *Administrative Regulations and Interpretations: The Control Test v. The Grandfather Rule*

Barely two months after the Palting decision was handed down by the Supreme Court, possibly as a response thereto, the Securities and Exchange Commission ("SEC") promulgated on February 28, 1967 the "Rules to Implement the Requirement of the Constitution and Other Laws that the Controlling Interests in Enterprises Engaged in the Exploitation of Natural Resources Shall be Owned by Filipino Citizens" ("1967 SEC Rules"). The 1967 SEC Rules adopted both the control test and the grandfather rule for purposes of determining the nationality of a corporate stockholder:

> 7. Determination of Citizenship in Case of Corporations or Partnership--
>
> (a) Shares belonging to corporations or partnerships at least 60% of the capital of which is owned by Filipino citizens shall be considered as of Philippine nationality, but if the percentage of Filipino ownership in the corporation or partnership is less than 60%, only the number of shares corresponding to such percentage shall be counted as of Philippine nationality. Thus, if 100,000 shares are registered in the name of a corporation or partnership at least 60% of the capital stock or capital, respectively, of which belongs to Filipino citizens, all of the said shares shall be recorded as owned by Filipinos. But if less than 60%, or say, only 50% of the capital stock or capital of the corporation or partnership respectively belongs to Filipino citizens, only 50,000 shares shall be counted as owned by Filipinos and the other 50,000 shares shall be recorded as belonging to aliens.

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[128] *Id.*, at 937-938; emphasis supplied.

Thus the control rule applies with respect to a corporation at least 60% of the capital of which is owned by Filipino citizens. In this case, the entire corporation shall be considered of Philippine nationality. On the other hand, the grandfather rule applies where the equity position of Filipino citizens is less than 60%. In the latter case, only the number of shares corresponding to the percentage of Filipino equity in the corporate stockholder is considered of Philippine nationality.

On September 7, 1972, the scope of application of the 1967 SEC Rules was expanded to include all industries nationalized under the 1935 Constitution. In ascertaining corporate nationality, the 1972 SEC Rules reiterated the 1967 formulation:

> 4. Determination of Citizenship in Case of Corporation, Partnership or Association
>
> (a) Shares belonging to corporations, partnerships or associations 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, partnership or association at least 60 percent of the capital stock or capital of which belongs 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, partnership or association belongs to Filipino citizens, only 50,000 shares shall be recorded as belonging to aliens.[129]

A few months earlier, the SEC had issued an opinion applying the control test with respect to an investment made by Bancom Development Corporation ("BANCOM"), a 70% Filipino corporation, in a mining corporation:

> As stated in your letter, 70% of the capital of BANCOM DEVELOPMENT CORPORATION is owned by Filipino citizens and the remaining 30% is American owned. Your question now is whether BANCOM DEVELOPMENT CORPORATION's investment in another company which will engaged in a non-metallic mining project, shall be considered as a Filipino national, or shall 70% only of its shares be counted as owned by Filipinos and the other 30% recorded as belonging to American.

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[129]Rules Requiring All Corporations, Partnerships and Associations with Alien Equity Ownership in Excess of Forty Percent to Submit Quarterly Reports.

> According to Section 7 of our 'RULES TO IMPLEMENT THE REQUIREMENT OF THE CONSTITUTION AND OTHER LAWS THAT THE CONTROLLING INTERESTS IN ENTERPRISES ENGAGED IN THE EXPLOITATION OF NATURAL RESOURCES SHALL BE OWNED BY FILIPINO CITIZENS', shares belonging to corporations or partnerships at least 60% of the capital of which is owned by Filipino citizens shall be considered as of Philippine nationality, but if the percentage of Filipino ownership in the corporation or partnership is less than 60%, only the number of shares corresponding to such percentage shall be counted as of Philippine nationality.
>
> Accordingly, if 70% of the capital of BANCOM DEVELOPMENT CORPORATION is owned by Filipino citizens, and 30% is owned by American citizens, all of said shares shall be recorded as owned by Filipinos. Thus, the investment by BANCOM DEVELOPMENT CORPORATION in the proposed corporation should be considered as a Philippine investment.[130]

However, the SEC has also opined that the "control test" does not apply in respect of corporations organized under the laws of other countries:[131]

> Section 7(a) of the rules promulgated by this Commission on February 28, 1967 provides for the determination of Philippine nationality in case of corporation as follows:
>
> > Shares belonging to corporations...at least 60% of the capital of which is owned by Filipino citizens shall be considered as of Philippine nationality...
>
> It will be noted that the aforequoted rule follows the control test in determining the Philippine nationality of a corporation engaged in the exploitation of natural resources in this country. It is sufficient under the rule that the subscribing corporation is owned to the extent of at least 60% of its capital stock by Filipino citizens, to be considered a Philippine national. This is pursuant to the provision of our Constitution which states, among others, that the exploitation of our natural resources shall be limited to Filipino citizens or to corporations or associations at least 60% of the capital of which belongs to Filipino citizens.
>
> *The aforesaid rules of the Commission, however, are intended to apply only to corporations and association subject to our laws and jurisdiction*

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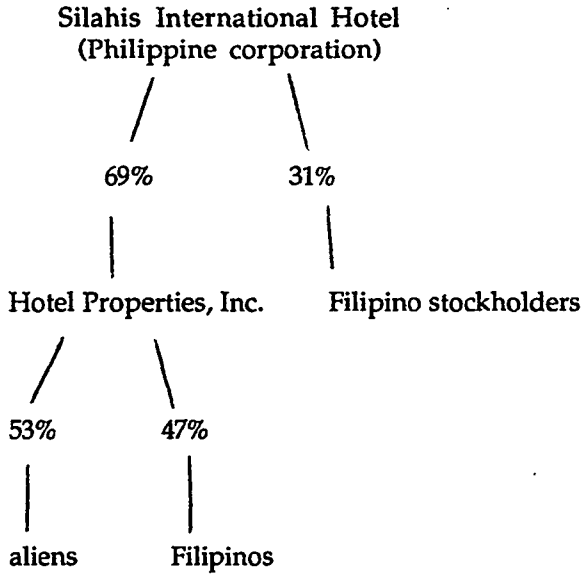
[130]SEC Opinion dated March 20, 1972 issued to Mr. Edward B. Golden.

[131]SEC Opinion dated January 19, 1973 addressed to Atty. Jaime Blanco.

> *and not to foreign corporations not licensed to do business in the Philippines. As regards such foreign entities, their shares of stock in a Philippine corporation engaged in the exploitation of our natural resources will be regarded as belonging to Filipinos only to the extent of the interest that Filipino citizens own in the foreign country...*

Unfortunately, in the period after the ratification of the 1987 Constitution, the position of the executive branch on the matter of the application of the control test vis-a-vis the grandfather rule has been marked by a certain degree of vacillation.

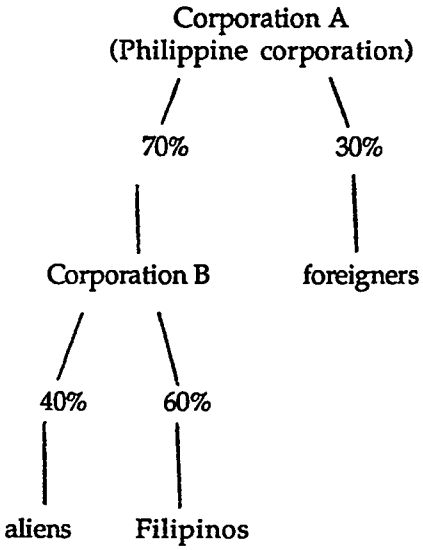
On May 4, 1987, the SEC issued an opinion applying the "grandfather rule" to determine the effective percentage of Filipino stock ownership in a corporation (Silahis International Hotel), the capital stock of which is 69% owned by another corporation (Hotel Properties, Inc.) and 31% owned by Filipino stockholders. Hotel Properties, Inc., in turn, is 53% alien- owned and 47% Filipino owned. Schematically, the intercorporate structure follows:



In the foregoing situation, the SEC found that Silahis International Hotel is qualified to engage in a partly nationalized business because the

Filipino equity in said corporation is 63.43% ([69% x 47%] + 31%), while the foreign equity is 36.57% (69% x 53%).[132]

On April 26, 1988, the Secretary of Justice issued a most controversial opinion. The query was whether or not there may be an investment in real estate by a domestic corporation ("Corporation A") 70% of the capital stock of which is owned by another domestic corporation ("Corporation B") with at least 60%- 40% Filipino-Foreign equity, while the remaining 30% of the capital stock is owned by a foreign corporation. The intercorporate structure in diagram form follows:



In the foregoing case, the Secretary of Justice applied the "grandfather rule" and held that inasmuch as Corporation A's Filipino equity is only 42% (70% x 60%) and its alien equity, 58% ([70% x 40%] + 30%), it is disqualified from investing in real estate, which is a nationalized activity as it does not meet the 60%-40% Filipino-Foreign equity requirement under the 1987 Constitution. Besides citing the 1987 SEC Silahis ruling, the Secretary of Justice gave the following rationale for his opinion:

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[132]SEC Opinion dated May 4, 1987 issued by SEC Chairman Julio A. Sulit addressed to the Board of Investments; hereinafter cited as the Silahis ruling.

> It is implicit in the constitutional provisions, even if it refers merely to ownership of stock in the corporation holding the land or natural resource concession, that the nationality requirement is not satisfied unless it meets the criterion of beneficial ownership, i.e., Filipinos are the principal beneficiaries in the exploration of natural resources (Op. No. 144, s. 1977; Op. No. 130, s. 1985), and that in applying the same "the primordial consideration is situs of control, whether in a stock or non-stock corporation" (Op. No. 178, s. 1974). As stated in Register of Deeds v. Ung Sui Si Temple (97 Phil. 58), the purpose of the sixty per centum requirement is obviously to insure that corporations and associations allowed to acquire agricultural land or to exploit natural resources "shall be controlled by Filipinos". Accordingly, any arrangement which attempts to defeat the constitutional purpose should be eschewed. (Op. No. 130, 1985)
>
> We are informed that in the registration of corporations with the Securities and Exchange Commission (SEC), compliance with the sixty per centum requirement is being monitored by SEC under the "Grandfather Rule", a method by which the percentage of Filipino equity in corporation engaged in nationalized and/or partly nationalized areas of activities provided for under the Constitution and other national laws is accurately computed, and the diminution of said equity prevented (SEC Memo, s. 1976). The "Grandfather Rule" is applied specifically in cases where the corporation has corporate stockholders with alien stockholdings, otherwise if the rule is not applied, the presence of such corporate stockholders could *diminish* the effective control of Filipinos.[133]

The conclusion reached by the Secretary of Justice in this instance is fraught with error. The Silahis ruling was in accordance with the 1967 and 1972 SEC Rules since the corporate stockholder's capital stock was less than 60% owned by Filipino citizens. In contrast, the foregoing case involved a corporate stockholder with the correct 60%-40% mix. Furthermore, SEC Memo, series of 1976 relied on by the Secretary of Justice in the foregoing opinion applied the referenced 1967 SEC Rules. Finally, Opinion No. 178, series of 1974, which was also relied on by the Secretary, is by its own words inapplicable to the case at hand:

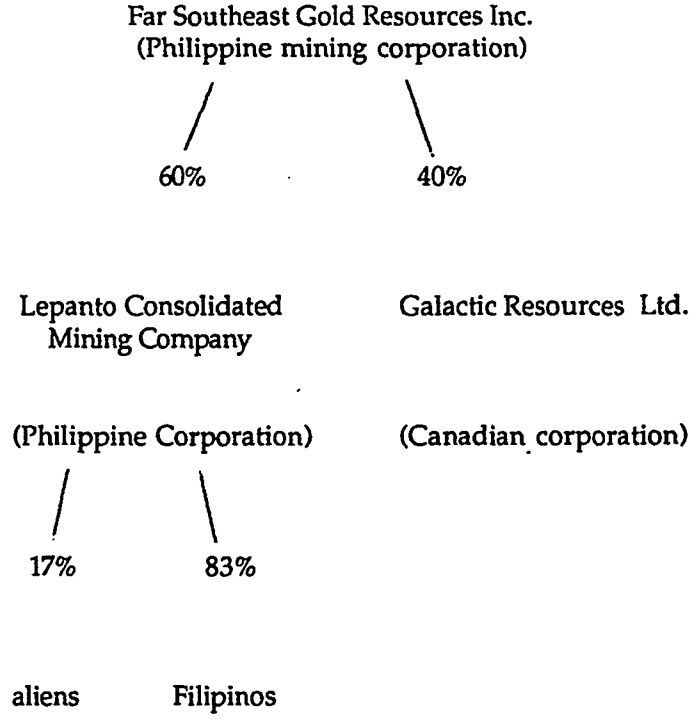
> In the first place, where pension plan trust funds are concerned, *it is not the nationality of a private corporation which is in question, the pension plan not being a private corporation.* Furthermore, even assuming that the plan is a corporation, it may not be said that its "controlling stockholders" are Filipinos merely because its

[133]Secretary of Justice Opinion No. 84 dated April 16, 1988 issued to Undersecretary Tomas I. Alcantara, Vice-Chairman, Board of Investments.

> beneficiaries, the employees, are Filipinos. For as already observed, the said beneficiaries-employees may not be considered owners or stockholders of the pension plan. It may not be correctly said that such beneficiaries hold control of the pension plan, as likewise already observed. Finally and significantly, even granting, again, that the Filipino employees-beneficiaries may be deemed 'stockholders' of the pension plan, it may not be correctly said that such beneficiaries hold control of the pension plan, as likewise already observed.....

Thus, the premises relied on by the Secretary of Justice indubitably did not justify the conclusion he reached.

On January 19, 1989, the Secretary of Justice, without admitting the same, in essence, reversed his conclusion in Opinion No. 84, series of 1988. In Opinion No. 18, series of 1989, the Secretary of Justice applied the 1967 and 1972 SEC Rules given facts similar to those obtaining under Opinion No. 84. An outline of the pertinent intercorporate structure follows:



While explicitly stating that the Opinion No. 18, series of 1989 was not meant to overrule Opinion No. 84, series of 1988, nevertheless, the Secretary of Justice opined that there was nothing in the latter that precluded the application of the 1967 and 1972 SEC Rules in appropriate cases.

> It is quite clear from said SEC rule that the "Grandfather Rule", which was evolved and applied by the SEC in several cases, will not apply in cases where the 60-40 Filipino-alien equity ownership in a particular natural resource corporation is not in doubt.[134]

Neither do the deliberations of the 1986 Constitutional Commission evince much needed elucidation on this issue. In one session, Commissioner Villegas categorically stated that the grandfather rule is adopted:

> *Mr. Nolledo* - In Sections 3, 9 and 15, the Committee stated local or Filipino equity and foreign equity; namely, 60-40 in Section 3, 60-40 in Section 9, and 2/3 - 1/3 in Section 15.
>
> *Mr. Villegas* - That is right.
>
> .....
>
> *Mr. Nolledo* - With respect to an investment by one corporation in another corporation, say, a corporation with 60-40 percent equity invests in another corporation which is permitted by the Corporation Code, does the Committee adopt the grandfather rule?
>
> *Mr. Villegas* - Yes, that is the understanding of the Committee.
>
> *Mr. Nolledo* - Therefore, we need additional Filipino capital.
>
> *Mr. Villegas* - Yes.[135]

On the other hand, during another session, it was made clear that the existing controls and regulations (*e.g.*, the 1967 and 1972 SEC Rules) continue in force and effect.

> *Mr. Maambong* - My next point is,-all these controls that we are talking about are embodied in our laws, and taken in totality these

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[134]Secretary of Justice Opinion No. 18 dated January 19, 1989 issued to the Chairman, Securities and Exchange Commission.

[135]III RECORDS OF THE CONSTITUTIONAL COMMISSION 255, Session of August 13, 1986.

> provision which we are now discussing do not, in any way, as of this moment and until Congress acts otherwise, destroy whatever controls or regulations are existing as of now.
>
> *Mr. Villegas* - No, they do not.[136]

Accordingly, it can be argued that Commissioner Villegas' comments must be harmonized especially since he headed the Committee that sponsored the Article on National Economy and Patrimony and thus, could not be presumed to be in the habit of taking inconsistent stance. Therefore, the referred to "adoption of the grandfather rule" under the 1987 Constitution must be taken in the light of the 1967 and 1972 SEC rules where the grandfather rule is applied only when the Filipino equity in a corporate stockholder is less than 60%. Moreover, the Commissioners, in the context of their interpellations on Article XII (National Economy and Patrimony) considered the term "qualified Filipinos" to comprehend both individuals and juridical entities:

> *Mr. Davide* - I want to get that meaning clear because `QUALIFIED FILIPINOS' may refer only to individuals and not to juridical personalities or entities.
>
> .....
>
> *Mr. Nolledo* - The amendment will read:`IN THE GRANT OF RIGHTS, PRIVILEGES AND CONCESSIONS COVERING THE NATIONAL ECONOMY AND PATRIMONY, THE STATE SHALL GIVE PREFERENCE TO QUALIFIED FILIPINOS.' And the word `Filipinos' here, as intended by the proponents, will include not only individual Filipinos but also Filipino-controlled entities or entities fully controlled by Filipinos.[137]

Consequently, it can be reasonably argued that the "control test" as implemented under the 1967 and 1972 SEC Rules is equally recognized under the 1987 Constitution.

V. FOREIGN INVESTMENTS: BOON OR BANE?

Developments in the Philippines in the last six months appear to indicate the beginnings of a new attitude towards foreign investment. Early in November, 1990, a joint committee of the Philippine government and mining industry officials conducted public hearings on a proposed package of

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[136]*Id.*, at 325, Session of August 14, 1986.

[137]III RECORDS OF THE CONSTITUTIONAL COMMISSION 608, Session of August 22, 1986.

incentives that would help entice foreigners to invest in Philippine mineral production. The draft of the "financial and technical assistance agreement" (FTAA) contains clauses that would allow foreigners to enter into a mining operation without being subject to the current 40% limit on foreign ownership.[138] Then, late March of the current year, the Philippine Congress made an unexpected volte face and approved legislation simplifying investment rules in a bid to attract badly needed foreign capital and revive the country's battered economy.[139] Under the draft law, foreign nationals may own up to 100% of domestic enterprises unless the latter is engaged in an industry included in a negative list to be drawn up annually by the National Economic Development Authority (NEDA).[140]

In view of recent events, the time is ripe to re-evaluate the role of foreign investments in the Philippine economy and more specifically, in its natural resource industry. Was it a prudent policy choice for the Philippines to impose limitations on foreign equity participation in the area of natural resource exploitation? Have the restrictions placed on foreign equity participation resulted in effective control by its nationals of its natural resource wealth? In what direction should these limitations be heading? To gain some insight into these issues, it would be best to first examine some general approaches to the issue of foreign investments in developing countries.

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[138]Philippines Looks to Attract Foreign Investors, Metals Week, November 5, 1990, at 7 (McGraw-Hill, Inc.; NEXIS). In order to bypass this rule, however, foreigners would have to invest at least US $ 50 million. The plan tentatively calls for dividing foreign investment into four stages. The "pre-exploratory" stage would come first. During this time, investors would search for ore bodies and decide whether the operation would meet the $ 50 million requirement. The second stage under the FTAA's terms would be a "recovery period" of three to five years. During this period, operations would receive a significant tax break on production and sales in order to help recover pre-exploratory costs. The third stage would be a "sharing period" of 10 to 15 years, during which time the government would get about 60% of an operation's net profit. The last stage would be a partial disinvestment by the foreign investor. After 20 years of operation, the foreign company would sell part of its equity to local investors in order to comply with the 40% limit on foreign ownership. This proposed incentive package is subject to revision based on input from public hearings. According to the Philippine Bureau of Mines and Geo-Sciences, the objective is to offer the best foreign investment terms among Southeast Asian countries.

[139]Reuter, Philippine Senate Approves Bill to Lure Investors, BC Cycle, March 20, 1991 (NEXIS). However, there is some disagreement between the Senate and the Lower House regarding the number of incentives to be offered. Thus a final version will still have to be threshed out in the Joint Committee. As of even date, the differences have not yet been reconciled.

[140]Philippine Senate Approves New Investment Law, Kyodo News Service, March 20, 1991 (NEXIS).

(1) General Analytical Approaches.

In the last two decades, a substantial amount of theoretical and empirical studies have emerged which attempt to evaluate the impact of foreign investment on the economic growth of developing countries.[141] "The literature on multinationals in the Third World is concerned with three central questions: Do developing countries benefit from foreign direct investment? What forces shape the distribution of gains between foreign firms and developing host countries? And what policies should developing countries follow toward multinationals?"[142] Currently, four schools of thought[143] are competing with each other, to wit: the pro-foreign direct investment approach, the Dependencia school, the Bargaining approach and the Structuralist perspective.[144]

The first three are relevant to the analysis of foreign investments in the natural resource industries of developing nations.[145]

Pro-Foreign Direct Investment

Under this theoretical framework, it is believed that the best prospects for speedy national economic growth would be to permit local and foreign private-sector enterprises to operate under competitive market conditions.[146] It advocates an open investment policy where few (if any) limitations or prohibitions are imposed on foreign investment. While foreign capital is not viewed as a panacea for Third World problems, it is viewed as a catalyst which can "energize domestic potential".[147] It is argued that foreign investment brings to the host country "a package' of cheap capital, advanced technology, superior management ability, and superior knowledge of foreign markets for both final products and capital

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[141]*See* Grieco, Foreign Investment and Development: Theories and Evidence in T. H. MORAN *et. al.*, INVESTING IN DEVELOPMENT: NEW ROLES FOR PRIVATE CAPITAL? 35 (1986).

[142]*Id.*

[143]*Id.*, at 35-60.

[144]The Structuralist approach is a theoretical framework pertinent to MNCs in the manufacturing industry per se, thus, not relevant to this paper.

[145]*Id.*, at 35-60.

[146]*Id.*, at 35-60.

[147]*Id.*, at 35-36.

goods, intermediate inputs, and raw materials."[148] In addition to transmitting technology, multinationals, according to the pro-foreign direct investment approach, serve as a major avenue for the developing country's exports which are needed to meet the foreign exchange and employment-creation requirements of the host country.[149] Finally, it is maintained that "Third World countries can enjoy these external benefits... while they augment their indigenous economic capabilities. For example, managers and workers trained by multinational corporations ("MNCs") can be available for local enterprises, and the very competition presented by multinationals induces local firms to aspire to greater efficiency."[150] Accordingly, under the pro-foreign investment school, the "key policy goal for developing countries is not to prevent being harmed by multinationals, but to accelerate the pace at which they receive a multitude of benefits from foreign enterprises."[151]

Dependencia School

"In contrast to the pro-foreign direct investment perspective, the dependencia school has emphasized the risks that multinationals pose for the Third World."[152] It argues that MNCs trap the host country in an exploitative relationship,[153] placing the latter at the mercy of an inequitous international trade system. Basically, it contends that "MNCs transfer technologies to developing countries that result in mass unemployment (capital-intensive instead of labor-intensive); that they monopolize rather than inject new capital resources; that they displace rather than generate or reinforce local businesses; and that they worsen rather than ameliorate these countries' balance-of-payments problems."[154] Dependencia writers contend that partial industrialization through the acceptance of foreign capital is achieved by the host country only "at the expense of the autonomy

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[148]*Id.*, at 36 *citing* P.T. BAUER, REALITY AND RHETORIC: STUDIES IN THE ECONOMICS OF DEVELOPMENT 32-33 (1984) and Drucker, Multinationals and Developing Countries: Myths and Realities, 53 FOREIGN AFFAIRS 126-127 (1974).

[149] Grieco, *supra* note 141, at 36 *citing* Johnson, Economic Benefits in H.R. HAHLO, J. GRAHAM SMITH AND R. W. WRIGHT, NATIONALISM AND THE MULTINATIONAL ENTERPRISE: LEGAL, ECONOMIC AND MANAGERIAL ASPECTS 168 (1977).

[150]Grieco, *supra* note 141 at 36.

[151]Grieco, *supra* note 141, at 37.

[152]*Id.*

[153]EAST-WEST CENTER, ASIA-PACIFIC REPORT: TRENDS, ISSUES, CHALLENGES 85 (1986).

[154]Grieco, *supra* note 141, at 37-38 *citing* Muller, The Multinational Corporation and the Underdevelopment of the Third World in WILBER, POLITICAL ECONOMY 173; parenthetical remark supplied.

of the national economic system and of policy decisions for development."[155] Thus, they conclude that the solution is for developing countries to "de-link" at least temporarily from the international economy and construct paths to socialism.[156]

Bargaining Approach

This school suggests that "the distribution of gains emerge from negotiations between foreign firms and host- country governments."[157] Thus, the strategy is to initially attract foreign investors into the country. After the foreign investor's operations are in place, the host country can then embark on a process of "squeezing" the foreign investor (the "obsolescing bargain").[158] This works through renegotiations of the terms of the relationship between the two. Over time, the balance of benefits should tilt increasingly in favor of the host country. This is particularly apropos to the natural resource industry. In this connection, three factors are anticipated to tip the scale in favor of the developing country in the long term -- reductions in risk upon the discovery of the mineral, international oligopolistic rivalry and the establishment of host country institutions and processes capable of exploiting these favorable conditions.[159] Accordingly, under the bargaining school, "beginning with elementary attempts to tighten the bargaining process, the country starts to move up a learning curve that leads from monitoring industry behavior to replicating complicated corporate functions."[160] Therefore, "the key policy prescription that has emerged from the bargaining school's analysis is that foreign direct investments ought to be permitted, even encouraged, by host governments and that these governments ought to build the national institutions needed to enhance the country's share of the resulting benefits."[161] Unlike the pro-foreign direct investment school, the bargaining school does not assume that host developing countries will automatically enjoy gains as a result of their acceptance of foreign direct investments. "On the other hand, in contrast to the dependencia school's view that multinationals increase their power over host countries or co-opt their national elites, the bargaining school has

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[155]Grieco, *supra* note 141, at 38 citing FERNANDO HENRIQUE CARDOSO & ENZO FALETTO, DEPENDENCY AND DEVELOPMENT IN LATIN AMERICA 162 (1979).

[156]*Id.*, at 39.

[157]*Id.*

[158]*Id.*, at 40.

[159]*Id.*

[160]*Id.*

[161]*Id.*, at 40-41.

found that the cleavage between host governments and foreign firms remains very deep and that the former do seek, with ever- greater levels of success over time, to extract increasingly significant gains from multinationals."[162]

Unfortunately, empirical studies conducted to ascertain how multinational corporations in developing countries affect the rate of aggregate growth of these countries and the distribution of income within them, have yielded conflicting results.[163] Much of the researches conducted in this field are so overburdened with methodological uncertainties that one cannot at this time draw conclusions from them with any minimally acceptable level of confidence.[164] However, many of the studies point to "the benefits of making the MNC operations more transparent to the host country and, perhaps even more significant, of exposing foreign firms to the competitive pressures of national firms and, especially, to those of other foreign firms. Transparency and competition appear to be the essential ingredients of bringing about a division of gains between the foreign enterprises and the host country that is progressively more favorable to the latter."[165] In the ultimate analysis, each developing country will need to devise its own preferred mixture of assertive and accommodating policies toward multinational enterprises."[166]

(2) *Importance of Foreign Investments to the Mining Industry*

How essential is foreign investment specifically to the development of mineral resources? Officials of international mining firms considered foreign investments to be virtually indispensable to the growth and efficient operation of minerals industries in developing countries. On the other hand, many government officials, including experienced mine managers in state enterprises, regard the foregoing attitude as chauvinistic and contend that foreign investment can be "depackaged" so that its various elements can be purchased at international market prices without paying "rents" to the international mining firms.[167] Empirical support for either position, however, tends to be weak and slanted.[168]

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[162]*Id.*, at 41.
[163]*Id.*, at 51.
[164]*Id.*
[165]*Id.*, at 52.
[166]*Id.*
[167]Mikesell, NEW PATTERNS OF WORLD MINERAL DEVELOPMENT 41 (1979).
[168]*Id.*

Without taking an extreme position on either side of the issue, Professor Raymond F. Mikesell, a renown international expert in this field, suggests the following reasons why foreign investment is important for exploration and development of the minerals industry in developing countries.

Greater Efficiency

"The larger the number of experienced international mining firms engaged in exploration and development in a country, whether it be Canada, Mexico, Peru, or the United States, the more efficient the mineral output of the country is likely to be. A government mining enterprise benefits from competition from private domestic and foreign mining enterprises that can provide a yardstick for measuring government performance. Those who take the position that all mineral development, or the development of certain minerals, should be planned and implemented by government must answer the charge that government planned and controlled economies have had a far poorer performance record than free-enterprise economies, and that a government monopoly in the minerals area is not likely to perform any better than one in industry or agriculture."[169]

Politically Independent Management

"Foreign direct investment is more capable of providing politically independent management, whether the managers are nationals or foreigners. Top management and boards of directors of government enterprises not only tend to be political appointees, but are under constant pressure to put certain national economic and political objectives above that of running the mining enterprise with a view to maximizing gross profits".[170]

Technology Transfer

"Foreign investment provides a continuing association with an experienced international mining firm for problem solving and for the introduction of new technology. Rarely do operations in mining and milling

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[169]*Id.*, at 41-42.
[170]*Id.*, at 42.

go as planned and without difficulties. No two ores are exactly alike, and problems in their treatment are very common in new mines."[171]

Reduced Assumption of Risks

Cyclical instability in the international minerals market has characterized much of this century.[172] For example, the early 1970s was a period of high and rising mineral prices. In contrast, the period starting the mid-1970s up until the late 1980s was characterized by depressed mineral prices.[173] It is axiomatic that developing countries have very little control over the international demand for natural resource commodities and corollarily, the latter's prices. As a result, the trend among resource rich countries indicates a decline in reliance on state equity participation and a shift to financial benefits through various forms of taxation and user charges.[174] On the other hand, "international mining companies are better able than governments to undertake the high risks of exploration, both because of the size of the financial resources they can command, relative to the budgets of many governments, and because of their ability to pool risks involved in many projects to produce a variety of minerals in many countries and regions through the world. Their ability to pool a large number of risks and to determine probabilities of success for each one reduces the overall cost of risk-taking as contrasted with that for most national government mining enterprise."[175]

Better Mobilization of Required Inputs and Loan Capital

"International mining companies are also better able than are government enterprises to mobilize the required technical and managerial inputs, together with the international loan capital, required for large mining projects. This is true even though government enterprises can hire the services of geologists, engineers, construction firms, and managers from a variety of sources throughout the world. Sometimes a government can hire an international mining firm to provide all the inputs for each phase of the

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[171]*Id.*

[172]Smith, Foreign Investment in Natural Resources: What Can Go Wrong?, a paper delivered at the Singapore Conference in International Business Law (August, 1990), at 2.

[173]*Id.*

[174]Reiner, Government Take in Pacific Rim Mining and Petroleum Developments: The Papua New Guinea Experience, a paper delivered at the International Resources Conference held at Denver in February, 1991, at 10-9.

[175]R.F. MIKESELL, *supra* note 167, at 42-43.

development of a mine. Such arrangements are costly and expose the government to all of the risks. Moreover, international mining firms tend to employ their best technical and managerial resources for their own projects, rather than use them on contract projects."[176]

Marketing Expertise

"In the case of minerals such as bauxite, iron ore and manganese for which organized international markets and commodity exchanges do not exist, vertically integrated international mining firms can provide a market for the output. Even for commodities such as copper, much of which is traded on a worldwide competitive basis, the marketing organizations and affiliate relationships of international mining firms are generally more efficient than the marketing staffs of government mining enterprises in the developing countries. The negotiation of long-term contracts to take the bulk of the output of a new mine during the debt repayment period is frequently a condition for obtaining the necessary international loan capital for its construction. International mining firms are in a better position to negotiate such contracts."[177]

Greater Ease in Raising Venture Capital

Equity participation by an international mining firm is frequently indispensable for raising the large amount of private or public international debt capital required for a modern mine.[178] International mining firms have better access to international banking consortia and credit from foreign suppliers of equipment. On the other hand, many developing countries are in the throes of a debt crisis that seriously impair their borrowing capacity.

In sum, the participation of foreign mining firms can greatly enhance the amount of exploration and the rate of development of the host country's mineral resources. They can provide the risk capital for exploration, localize the debt and equity financing for the project, negotiate long-term contracts for the sale of the output, furnish experienced and politically

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[176]*Id.*, at 43.
[177]*Id.*
[178]*Id. See* also R. BOSSON & B. VARON, THE MINING INDUSTRY AND THE DEVELOPING COUNTRIES 45 (1977).

neutral management, and provide a channel for technical and financial problem solving and for the introduction of new technology.[179]

(3) Policy Recommendations

Clearly, even under a middle-of-the-road view, foreign investments have a lot to offer the mining industry in a developing country such as the Philippines. Accordingly, the current impasse between the control test and the grandfather rule should be resolved in favor of the former. The 1967 and 1972 SEC rules should be enforced without further irresolution. In this manner, an unsettling uncertainty in the investment climate will be removed. This will improve the Philippines' ability to attract foreign investment vis-a-vis the stiff competition it now faces from its Asian neighbors.[180] Moreover, it is the only administratively feasible course of action the Philippines can take. Unless the Philippines has the administrative capability for tracing Filipino ownership ad infinitum, it has to accept the reality of intercorporate holdings in modern corporate practice. In view of the cyclical instability which characterizes the mining industry, the implementation of the 1967 and 1972 SEC rules would be a prudent way of reducing the risk exposure of Filipinos in the years to come without sacrificing "control". The Philippines should follow the trend among other resource rich countries which indicates a declining reliance on state equity participation and a shift to fiscal measures in capturing the maximum resource rent from natural resource projects. After all symbolic ownership is meaningless if the foreign counterparty ends up with most of the resource rent or economic benefits from the natural resource wealth of the host country. Thus, for example, upswings in the market prices of natural resource commodities can be better-captured through additional profits tax or the resource rent concepts of taxation without the government being exposed to capital and project risk. Under the resource rent (or additional profits) tax concept, all or part of taxation is triggered after the investor has recovered

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[179] *Id.*, at 47 and 45.

[180] In 1989, total approved investments, domestic and foreign in the Philippines reached $ 3.2 billion. Thailand's figures was 3.5 times larger while that of Indonesia's was 5.5 times bigger. In addition, Philippine officials are currently apprehensive about new competition from Vietnam. (Isberto, Philippines: Competing with South-East Asia's New "Tigers", Inter Press Service, April 3, 1991 (NEXIS)). *See* also Lehner, Foreign Direct Investment in Asia Shifts: U.S. Viewed as Overshadowed by Regional Sources, WALL STREET JOURNAL, April 8, 1991, at A14.

his investment and a specified internal rate of return.[181] Or alternatively, a higher than normal rate of tax on the mining company can be imposed only after it has earned a reasonable return on its investment. In this connection, Article 5.2 of Administrative Order No. 57 of the Philippine Department of Environment and Natural Resources, series of 1989, currently provides for the government's share in windfall profits. Under this article, windfall profits pertain to profits above a reference rate of return which will be negotiated between the government and the mining company. Unfortunately, this concept was totally eliminated in the proposed Mining Code. It should be restored to enable the government to capture those windfall profits that merely flow from cyclical increases in commodity prices and are not attributable to any increased efficiency on the part of, or new technology introduced by the mining company. In addition, the Philippines should streamline its tax administration. In a recent comparative survey made on government take in the Pacific Rim region in the area of hydrocarbon taxation systems ("Annex 1"), the Philippines has the lowest government take compared to Malaysia, Indonesia, Brunei, Thailand, and Papua New Guinea. Unless this is really the intent of the Philippine government in its effort to attract foreign investments in the area of hydrocarbons, it should explore the possible existence of loopholes in the system. Perhaps, tax deductions taken and transfer prices in affiliate transactions can bear further scrutiny. Also, the pervasiveness of this problem among resource-rich countries indicates a potentially fruitful area for interregional cooperation.

Finally, we have to ascertain whether placing limitations on foreign equity participation per se contributes to effective control by Filipino nationals of the natural resource wealth of the country. In this connection, the Philippines can take heed from the experience in other developing countries –

> Control...rarely corresponded to the degree of equity ownership... A long list of cases bears witness to the fact that, although they might take way the insignia of ownership, countries may not be able to assume concomitant economic control over the management of a mine.[182]

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[181] Walde, Investment Policies in the International Petroleum Industry Responses to the Current Crisis 12, a draft paper prepared for conference presentation, available through Vice Dean David N. Smith's class in Foreign Investments in Natural Resources (Spring, 1991). Mr. Thomas Walde is currently the Interregional Adviser on Petroleum and Mineral Legislation, Natural Resources and Energy Division, Department of Technical Cooperation for Development, United Nations.

[182] ASANTE, *supra* note 36, at 58.

Amidst the rhetoric of politics, the Philippines has to determine for itself just what it envisions by "effective control". Only by getting down to brass tacks can concrete solutions be forged. Personally, I believe the concept of "effective control" transcends mere ownership and enjoyment of the fruits (dividends) thereof. It means a condition when all the stages of the mining process can be effectively and efficiently operated by the host country or its nationals, independently of foreigners and at par with foreigners. In concrete terms, this refers to a scenario where the transfer of management, production, technology and marketing expertise is complete and Filipinos need no longer depend on foreigners, unless it is by calculated choice. Towards this end, the Philippine government should adhere to the bargaining school of thought and in time, exact not only the best possible share in terms of economic gains, but also the most knowledge and skills in all the areas of mining that can be transmitted from foreign investors. Initially, this can done through reporting and training requirements. Subsequently, indigenization requirements for certain top key positions can be imposed. The experience of other nations, however, has been that nationals, appointed to top level positions frequently take the viewpoint of foreign headquarters in view of the absence of a set of accepted policies and operational guidelines on public resource development policy.[183] Thus, "public authorities must be in a position to formulate a natural resource policy which is sufficiently clear and flexible to serve as guidelines for management decisions. The degree of control will then be influenced by the ability of a national manager to establish a working compromise between the interests of the enterprise, the management he is entrusted with, and public policy guidelines."[184] To overcome foreign orientation on the part of Filipino university graduates or to reduce the possibility of the Filipino elite being co-opted by foreign interests, the university system should be altered to introduce a more nationalistic bent and greater awareness of national resource policies:

> (T)he ease with which strategies for mineral development may be conceived contrasts sharply with the tortuous and difficult nature of the actual process of exerting effective control over resource operations. Neither independently planned economic goals nor an all-out nationalization effort proved to be the cure for the ills of dependency. Most of the countries soon came to realize that neither political proclamation nor legislative activity alone could take them closer to the distant goal of control. They realized from experience that a radical

[183]ASANTE, *supra* note 36, at 61.
[184]*Id.*

> change in ownership through nationalization or higher fiscal impositions did not automatically result in more control.[185]

Actual control does not irresistibly flow from the extent of ownership or the type of contractual arrangement chosen for a particular operation, or the content of legislative transfers to national entities. It has become apparent that control can only be effectively exercised if sufficient and appropriate capacity for control exists.[186]

In the ultimate analysis, "sufficient and appropriate capacity for control" requires clear vision and vigilance on the part of government officials charged with the task of managing the natural resource wealth of the Philippines. But more importantly, resource nationalism must lie in the hearts and minds of its nationals. Dependency, after all, is first and foremost, a state of the mind.

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[185]ASANTE, *supra* note 36, at 54.
[186]*Id.*, at 60; emphasis supplied.