ASSESSING COMPLIANCE WITH FOREIGN OWNERSHIP RESTRICTIONS UNDER *NARRA NICKEL*[*]

NOTE

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INTRODUCTION

The 1987 Constitution was drafted at a time of increased nationalism, [1] resulting in a basic law that was "protective of things Filipino."[2] Quite explicitly, one of the main concerns of the basic law was to "develop a self-reliant and independent national economy effectively controlled by Filipinos."[3] Hence, several provisions in the 1987 Constitution were devoted to nationalizing industries and economic areas vested with the highest public interest. [4] Almost three decades after its ratification, the Constitution continues to be interpreted in light of the paradigm in 1987. Meanwhile, public opinion has at least partly shifted to creating a more liberal investment climate in the interest of economic growth and prosperity.[5]

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[1] The framers themselves were caught in intense debates on what should prevail between "a liberal economic policy balanced by concern for social justice and [...] a more protectionist constitution because of distrust of foreign and local business magnates." JOAQUIN G. BERNAS, SJ, THE 1987 CONSTITUTION OF THE REPUBLIC OF THE PHILIPPINES: A COMMENTARY 1005-6 (1996 ed.).

[2] *Id.* at 1006.

[3] CONST. art II, § 19.

[4] Art. XII, §§ 2, 10, 11 & 14, on public utilities, land, natural resources, and the practice of professions; art. XVI, § 11, on mass media and advertising. *See also* Manila Prince Hotel v. Gov't Service Insurance System, G.R. No. 122156, 267 SCRA 408, Feb. 3, 1997, as to the Filipino First Policy.

[5] In the past two decades, Congress has enacted several laws aimed at liberalizing the economy. *See* Rep. Act No. 7042, as amended (1996), § 2 [Foreign Investments Act, hereinafter "FIA"]; Rep. Act No. 8762 (2000) [Retail Trade Liberalization Act of 2000],

Caught between the tug-of-war of these competing concerns are important, practical questions. Among these is how to determine the extent of foreign ownership in corporations where one or more investors are themselves juridical persons, such as other corporations. For years, this issue was largely left to the determination of administrative agencies. That changed in 2014, with the Supreme Court's promulgation of *Narra Nickel Mining and Development Corp. v. Redmont Consolidated Mines Corp*,[6] which definitively outlined how this particular issue must be resolved.

This paper aims to clarify the Court's ruling in *Narra Nickel* by separating the current state of the law from an analysis of the ruling itself and its components. This methodology should allow us to clearly assess the soundness of the case's legal and political bases, its implications, and the judiciousness of the policy decision inevitably made by the Court in laying down the *Narra Nickel* rules—without confusing it with what those rules actually are.

In Part I, we discuss the current state of the law on foreign investment restrictions by identifying nationalized and partly nationalized industries and laying down the tests in determining the extent of foreign ownership in juridical investors. We then trace the administrative and judicial practice with regard to these tests before ending with a summary of the *Narra Nickel* decision. In Part II, we critique the *Narra Nickel* ruling as to the persuasiveness the Court accorded related administrative rulings, the distinction between the tests applied for foreign investment restrictions as embodied in the Constitution and in statutes, and its use of the record of the Constitutional Commission as its primary aid in construing the Constitution. In Part III, we then offer our suggestions on which test should be applied, depending on different policy and non-policy considerations.

We believe this paper is relevant for several reasons. First, the determination of the extent of foreign ownership in corporations with juridical investors was previously left to administrative agencies. *Narra Nickel* is the first case where the Supreme Court made an authoritative pronouncement as to how this determination must be made; because judicial

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repealing Rep. Act No. 1180 (1954) [Retail Trade Nationalization Law]. *See* Nat'l Econ. and Dev. Auth., Implementing Rules and Regulations of Republic Act No. 7042 (Foreign Investment Act of 1991) as amended by Republic Act No. 8179 (1996) [hereinafter "FIA IRR"]. *See also* H./S. Res. 1, 16th Cong., 1st Sess. (2013) [Resolution of Both Houses Proposing Amendments to Certain Economic Provisions of the 1987 Constitution of the Republic of the Philippines Particularly on Articles II, XII & XVI], currently pending before the House of Representatives.

[6] G.R. No. 195580, 722 SCRA 382, Apr. 21, 2014.

decisions interpreting the Constitution form part of the Philippine legal system,[7] administrative agencies must adhere to *Narra Nickel* in their quasi-judicial adjudication. Second, *Narra Nickel* comes at the heels of *Gamboa v. Teves*,[8] another landmark case on foreign ownership restrictions. These two sets of rulings, released in a span of five years, have definitively laid down tests for resolving issues on foreign ownership. At the same time, they have been often criticized as inconsistent or difficult to comprehend.[9] Third, *Narra Nickel* was decided the year prior to the ASEAN Integration, a phenomenon which is expected to increase cross-border trade and investment in the region.[10] A clear, nuanced understanding of *Narra Nickel* is important not only in making investment decisions in nationalized industries, but also in building a consistent, stable, and predictable line of jurisprudence on the issues discussed therein.

I. CURRENT STATE OF THE LAW ON FOREIGN INVESTMENT RESTRICTIONS

A. Areas of Restricted Foreign Investment

Restrictions on the capacity of aliens to own and control corporations in particular investment areas in the Philippines are found in the Constitution and certain statutes.

Constitutional limitations on the extent of foreign ownership depend on the nature of the activity or industry. On the one hand, there are Constitutional provisions that impose a maximum allowable percentage of foreign equity in certain areas such as advertising;[11] the exploration, development and utilization of natural resources;[12] the ownership of private lands;[13] the operation and management of public utilities;[14] and the ownership, establishment and administration of educational institutions.[15] On the other hand, there are absolute prohibitions in the Constitution on

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[7] CIVIL CODE, art. 8.

[8] G.R. No. 176579, 652 SCRA 690, June 28, 2011; 682 SCRA 397, Oct. 9, 2012 (Res. Mot. Recon.).

[9] As far as *Narra Nickel* goes, this paper aims to separate the *is* and the *ought* of the law on determining the extent of foreign ownership.

[10] *See* ASS'N OF SOUTHEAST ASIAN NATIONS, ASEAN ECONOMIC BLUEPRINT (2008), *available at* http://www.asean.org/archive/5187-10.pdf (last accessed June 10, 2015).

[11] CONST. art. XVI, § 11(2).

[12] Art. XII, § 2.

[13] Art. XII, § 2.

[14] Art. XII, § 11.

[15] Art. XIV, § 4.

alien participation in the practice any profession in the Philippines[16] and the ownership and management of mass media.[17] The first class is often referred to as *nationalized* industries, while the second is called *partly* or *partially nationalized*.[18]

The power of Congress to legislate restrictions on the right of aliens to participate in certain areas of investment is recognized under the Constitution.[19] Through the enactment of the Foreign Investments Act [hereinafter, "FIA"], Congress mandated the creation of a Foreign Investment Negative List which has two component lists: (1) List A, which enumerates areas of activities reserved to Philippine nationals by mandate of the Constitution and specific laws; and (2) List B, which includes defense-related activities and those which have implications on public health and morals.[20] The power to pass amendments to the Negative List has been delegated by Congress to the National Economic Development Authority [NEDA], together with certain executive departments, with respect to List B.[21] To date, it is the Ninth Regular Foreign Investment Negative List[22] that contains the most recent listing of investment areas exclusively and partly reserved to Philippine nationals.

B. Tests in Determining the Extent of Foreign Ownership

Two tests in determining the extent of foreign ownership in a corporation were discussed by the Supreme Court in *Narra Nickel*, namely,

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[16] CONST. art. XII, § 14.

[17] Art. XVI, § 11(1).

[18] *See* II JOSE CAMPOS, JR. & MA. CLARA L. CAMPOS, THE CORPORATION CODE: COMMENTS, NOTES, AND SELECTED CASES 485 *et seq.* (1990).

[19] CONST. art. XII, § 10. Part of the provision reads:

> The Congress shall, upon recommendation of the economic and planning agency, when the national interest dictates, reserve to citizens of the Philippines or to corporations or associations at least sixty per centum of whose capital is owned by such citizens, or such higher percentage as Congress may prescribe, certain areas of investments. The Congress shall enact measures that will encourage the formation and operation of enterprises whose capital is wholly owned by Filipinos[.]

[20] FIA, § 8.

[21] Amendments to List B may be made upon the recommendation of the Secretary of National Defense, or the Secretary of Health, or the Secretary of Education, Culture and Sports [now Secretary of Education], endorsed by the NEDA, approved by the President, and promulgated by a Presidential Proclamation. FIA, § 8.

[22] Exec. Order No. 98 (s. 2012).

the control test and the grandfather rule. The Court derived these tests based on an administrative interpretation of the first sentence of paragraph 7(a) of the 1967 Rules of the Securities and Exchange Commission [SEC],[23] the agency with supervisory and control powers over corporations, partnerships, and associations who are grantees of, among others, a license or permit to operate in the Philippines.[24] It is of interest that the text of the 1967 SEC Rules does not assign the terms "control test" and "grandfather rule," although later SEC opinions would use those designations. It was the Department of Justice [DOJ], through a 2005 Opinion,[25] which confirmed said SEC Rule as providing for both tests. The two parts, as dissected by the DOJ, are outlined below:

> (1) *Control test*: "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[.]"
> (2) *Grandfather rule*: "[B]ut 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." [26]

Aside from the 1967 SEC Rules, the application of the control test is also supported by the FIA. The FIA prescribes registration requirements for investors who are "non-Philippine Nationals"[27] and provides for the creation of a list of investment areas reserved to "Philippine Nationals."[28] A "Philippine National," as defined in Section 3(a) of the FIA, includes "a corporation organized under the laws of the Philippines of which at least sixty percent (60%) of the capital stock outstanding and entitled to vote is owned and held by citizens of the Philippines."[29] The FIA does not label Section 3(a) as the "control test," but the same provision, as applied, essentially adopts it. Moreover, the FIA does not contain a proviso similar to the aforementioned grandfather rule. Meanwhile, the Implementing Rules of

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[23] Sec. and Exchange Comm'n [SEC], Rules to Implement the Requirements 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) [hereinafter "SEC Rules (1967)"].

[24] Pres. Dec. No. 902-A (1976), § 3 [Reorganization of the Securities and Exchange Commission with Additional Powers and Placing the said Agency under the Administrative Supervision of the Office of the President.] The powers of the SEC under Pres. Dec. No. 902-A were retained under the reorganization of the agency done under the Securities Regulation Code. Rep. Act No. 8799 (2000), § 5.1.

[25] Dep't of Just. [DOJ] Op. No. 20 (s. 2005).

[26] SEC Rules (1967), ¶ 7(a).

[27] FIA, § 5.

[28] § 8.

[29] § 3(a).

the FIA explicitly states that "[t]he control test shall be applied" for the purpose of determining whether a corporation is a Philippine National.[30]

C. The Tests as Applied Prior to *Narra Nickel*

1. The Tests as Applied by the Supreme Court

Narra Nickel is not the first occasion when the Supreme Court resorted to the control test or the grandfather rule in determining the extent of foreign ownership in a corporation. Prior to *Narra Nickel*, the Court had applied versions of both tests but with regard to very particular circumstances. Moreover, until 2014, the Court had never made a definite pronouncement as to which test or tests should actually be applied in the *general* case.

The control test was already used by the Court in determining the nationality of corporations under the Trading with the Enemy Act.[31] Under this statute, which restricts trade between the United States and its enemies during wartime, an "enemy" was defined to include "any [...] body of individuals, of any nationality, resident within the territory [...] of any nation with which the United States is at war, or resident outside the United States and doing business within such territory[.]" In *Filipinas Cia. de Seguros v. Christern, Heunefeld & Co, Inc.*,[32] the Court was asked to rule whether the respondent corporation, which was organized under the laws of the Philippines, qualified as an enemy under the Act and was therefore barred from claiming against the petitioner insurance corporation for losses sustained during the Japanese occupation in 1942. While recognizing that the insurance contract was executed before the war in October 1941, the Court held that because a majority of the stockholders of the respondent corporation were German subjects, the corporation became an enemy from the time the US declared war against Germany in December 1941.[33] Furthermore, in overruling respondent's contention that "a corporation is a citizen of the country or state by and under the laws of which it was created or organized," the Court cited the US Supreme Court's ruling in *Clark v. Uebersee Finanz Korporation, A.G.*, which supposedly held that the "control test" should be applied to this type of cases.[34]

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[30] FIA IRR, Rule I, § 1(b).
[31] 40 Stat. 411 (1917).
[32] 89 Phil. 54 (1951).
[33] *Id.* at 56.
[34] *Id.* (Citations omitted.)

Parenthetically, prior to *Filipinas Cia. de Seguros*, the Court applied what is commonly known as the *place of incorporation* test, which looks only to the country under whose laws a corporation was organized in order to determine its nationality.[35] As mentioned, the Court expressly overturned this test in *Filipinas Cia. de Seguros*, but apparently only insofar as the Trading with the Enemy Act was concerned. This test, nevertheless, is codified in Philippine statute books through the Corporation Code;[36] however, courts and administrative agencies have not applied this test in the matter of foreign ownership restrictions, as the text of said Constitutional and statutory limitations refer explicitly to the ownership of capital as the controlling consideration.

Meanwhile, the grandfather rule was already applied by the Court as early as *Palting v. San Jose Petroleum, Inc.*[37] San Jose Petroleum, a corporation organized under the laws of Panama, sought to register with the Philippine SEC a sale of its shares of stock, the proceeds of which would finance the operations of San Jose Oil, Inc., a domestic mining corporation. This registration was opposed by prospective stockholders who claimed, among others, that San Jose Petroleum was not an American business enterprise entitled to parity rights in the Philippines.[38] The Court reversed the SEC and held that San Jose Petroleum did not enjoy parity rights because it was not a

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[35] *See* Haw Pia v. The China Banking Corp., 80 Phil. 604 (1948). In finding that the respondent corporation was an enemy, the Court held that "[t]he defendant-appellee, China Banking Corporation, comes within the meaning of the word 'enemy' as used in the Trading with the Enemy Acts of civilized countries, because not only [was it] controlled by Japan's enemies, but *it was, besides, incorporated under the laws of a country with which Japan was at war.*" *Id.* at 622. (Emphasis supplied.) The Court in *Filipinas Cia. de Seguros*, 89 Phil. 54 (1951), used this to support its position that corporate nationality was properly determined using the control test.

[36] "For the purposes of this Code, a foreign corporation is one formed, organized or existing under any laws other than those of the Philippines and whose laws allow Filipino citizens and corporations to do business in its own country or state." CORP. CODE, § 123.

[37] G.R. No. 14441, 18 SCRA 924, Dec. 17, 1966.

[38] The antecedents of the appeal occurred during the parity rights regime, a period when Americans were given the right to "dispose, exploit, develop, and utilize 'all agricultural, timber, and mineral lands' of the Philippines, together with the operation of public utilities and the exploitation of the 'waters, minerals, coal, petroleum, and mineral resources of the Philippines"—rights which were originally reserved to Filipino citizens. TEODORO A. AGONCILLO, HISTORY OF THE FILIPINO PEOPLE 433-434 (8th ed., 1990). The parity rights were enacted by Constitutional amendment, which granted the rights to "citizens of the United States and to all forms of business enterprises 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" until 1974. CONST. (1935) ord.

corporation directly or indirectly owned or controlled by citizens of the United States, as required by the Constitution.[39]

In reaching its conclusion, the Court found from the record that the majority interest of San Jose Petroleum was owned by Oil Investments, Inc., another Panamanian company. This latter foreign corporation was in turn wholly owned by two corporations organized under the laws of Venezuela. The Court held that San Jose Petroleum was "not owned or controlled *directly* by citizens of the United States, because it is owned and controlled by [...] another foreign (Panamanian) corporation." Furthermore, it found that "neither can it be said that it is *indirectly* owned and controlled by American citizens through [Oil Investments, Inc.], for this latter corporation is in turn owned and controlled, not by citizens of the United States, but still by two foreign (Venezuelan) corporations."[40] The Court, however, refused to dig deeper than this third level, grounding its refusal on the intent of the law and practical considerations:

> [T]o hold that the set-up disclosed in this case, with a long chain of intervening foreign corporations, comes within the purview of the Parity Amendment regarding business enterprises indirectly owned or controlled by citizens of the United States, is to unduly stretch and strain the language and intent of the law. For, to what extent must the word "indirectly" be carried? Must we trace the ownership or control of these various corporations *ad infinitum* for the purpose of determining whether the American ownership-control-requirement is satisfied? Add to this the admitted fact that the shares of stock of the [two Venezuelan corporations] 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.*[41]

The record suggests that had the Court done so, it might have some factual basis to uphold the SEC ruling, as the stocks in the Venezuelan corporation were owned by several thousand residents of the United

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[39] Relative to this area of the economy, the 1935 Constitution reserved it to citizens of the Philippines and the United States and "corporations or associations at least sixty per centum of the capital of which is owned by such citizens." CONST. (1935) art. XIII, § 3, *in relation to* CONST. (1935) ord.

[40] Palting v. San Jose Petroleum, Inc., 18 SCRA at 937. (Emphasis in the original.)

[41] *Id.* at 937-38. (Emphasis supplied.) The impracticalities of the grandfather rule are discussed in Part III of this paper.

States.[42] What is peculiar about this case then is that it would have been likely to the benefit of the registrant foreign corporation, San Jose Petroleum, if the grandfather rule were applied to its fullest extent, i.e. up to the natural persons who held the shares of stock.

Until *Narra Nickel*, the only other time that the grandfather rule was mentioned by the Court was in its resolution on the motion for reconsideration in *Gamboa v. Teves*.[43] However, it only did so to emphasize that in questions on the extent of foreign ownership in corporations, what is important is that "ownership and control" remain vested in Filipinos. Which test must be applied to juridical investors was not one of the issues in *Gamboa*, and the grandfather rule therein cited[44] is mere *obiter dictum*.

2. The Tests as Applied by the SEC

To reiterate, while the control test and the grandfather rule were applied by the Court in its previous decisions, *Narra Nickel* was the first case where the Court chose between the control test and the grandfather rule in determining whether a corporation complied with the nationality requirements in the Constitution. Yet even before *Narra Nickel* was promulgated, disputes and legal queries involving the same issue were not uncommon. Over the past few decades, it was the SEC which had the opportunity to render advisory opinions and rulings that categorically decided which between the two tests was applicable. A discussion of how the SEC resolved issues on nationality requirements is, thus, pertinent.

For purposes of understanding the application of the grandfather rule in *Narra Nickel*, the 2010 Ruling of the SEC in *Redmont Consolidated Mines Corp. v. McArthur Mining Inc.*[45] will be the reckoning point in illustrating the different treatment given by the SEC in applying the two tests. We note that *Redmont* was significant to the Court's decision in *Narra Nickel* because of the similarity in the manner by which the SEC in *Redmont* and the Court justified the application of the grandfather rule.

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[42] Palting v. San Jose Petroleum, Inc., 18 SCRA at 933. In any event, the Court correctly pointed out that the record did not disclose the *citizenship* of these stockholders.

[43] G.R. No. 176579, 682 SCRA 397, Oct. 9, 2012 (Res. Mot. Recon.).

[44] The Court cited Redmont Consolidated Mines, Corp. v. McArthur Mining, Inc., *infra* note 23. *Gamboa*, 682 SCRA at 422.

[45] SEC En Banc Case No. 09-09-177 (Mar. 25, 2010).

i. SEC Opinions Prior to *Redmont*

The SEC, between late 1987 and 2010, uniformly applied the control test in its opinions.[46] The control test of the SEC was typically phrased as follows:

> 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.[47]

Interestingly, the second clause of the SEC's control test pertains to the common formulation of the grandfather rule.

However, in 1988, the DOJ issued Opinion No. 84 (s. 1988) which expressly applied the grandfather rule. Opinion No. 84 involved the question of whether or not a corporation would be considered "Filipino" so as to qualify it to legally purchase and hold real estate in the Philippines when 70% of the capital stock of the investing corporation is held by another domestic corporation with at least 60%–40% Filipino-foreign equity, while the remaining thirty (30%) of the capital stock is owned by a foreign corporation. The DOJ, citing the 1987 SEC opinion on Silahis International Hotel,[48] used the grandfather rule to arrive at the conclusion that based on the information presented to it, only 42% of the subject corporation could be considered Filipino equity.[49]

The next year, the DOJ clarified that its use of the grandfather rule in the above opinion did not foreclose the application of the 1967 SEC

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[46] *See* SEC Op. No. 11-06-1989 (Nov. 6, 1989); SEC Op. No. 12-14-1989 (Dec. 14, 1989); SEC Op. No. 01-02-1990 (Jan. 2, 1990); SEC Op. No. 05-30-1990 (May 30, 1990); SEC Op. No. 08-06-1991 (Aug. 6, 1991); SEC Op. No. 03-23-1993 (Mar. 23, 1993); SEC Op. No. 04-14-1993 (Apr. 14, 1993); SEC Op. No. 12-07-1993 (Dec. 7, 1993); SEC Op. No. 07-24-2002 (July 24, 2002); SEC-OGC Op No. 17-07 (Sept. 27, 2007); SEC-OGC Op. No. 18-07 (Nov. 28, 2007); SEC-OGC Op. No. 19-07 (Nov. 28, 2007); SEC-OGC Op. No. 20-07 (Nov. 28, 2007); SEC-OGC Op. No. 21-07 (Nov. 28, 2007); SEC-OGC Op. No. 22-07 (Dec. 7, 2007); SEC-OGC Op. No. 09-09 (Apr. 28, 2009); SEC-OGC Op. No. 08-10 (Feb. 8, 2010).

[47] SEC Op. No. 12-14-1989 (Dec. 14, 1989).

[48] SEC Op. No. 05-04-1987 (May 4, 1987).

[49] DOJ Op. No. 84 (s. 1988).

Rules.[50] The SEC would then consistently cite this later opinion, DOJ Opinion No. 18 (s. 1989), as its basis in applying the control test.

This same DOJ Opinion No. 18 (s. 1989), involving a determination of the nationality of Far Southeast Gold Resources, Inc. (a company engaged in mining activities) for the purposes of owning land in the Philippines, was, however, the first administrative issuance which appeared to create a "doubt exception" to the control test—an exception later adopted by the Court in *Narra Nickel*.[51] Under this exception, where there is doubt as to the foreign equity ownership of an investor corporation, the relevant agency would be justified in factoring only the shares owned by Filipinos in assessing compliance with the nationality requirement. This "doubt exception," however, was phrased in the negative by the DOJ:

> 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*.[52]

Aside from this 1989 DOJ Opinion, the SEC would later rely on Section 3(a) of the FIA and its Implementing Rules and Regulations as the basis for the control test.[53] We note that the control test as spelled out in the FIA was applied regardless of whether the foreign ownership limitation was prescribed by the Constitution or a statute.

Hence, prior to *Redmont*, the SEC applied the grandfather rule in a manner consistent with the text of the 1967 SEC Rules. In other words, whenever the SEC would make a determination that the percentage of Filipino ownership in a corporation is *less than* 60%, it would proceed to trace the individual stock ownership of the corporate shareholder and apply the grandfather rule.[54]

We likewise note that the SEC limited its application of the grandfather rule to three instances: (1) when a corporation is engaged in

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[50] DOJ Op. No. 18 (s. 1989).

[51] "When in the mind of the Court there is doubt, based on the attendant facts and circumstances of the case, in the 60-40 Filipino-equity ownership in the corporation, then it may apply the 'grandfather rule.'" *Narra Nickel*, 722 SCRA at 439.

[52] DOJ Op. No. 18 (s. 1989). (Emphasis supplied.)

[53] *See* SEC Op. No. 04-14-1993 (Apr. 14, 1993); SEC Op. No. 12-07-1993 (Dec. 7, 1993); SEC-OGC Op. No. 17-07 (Sept. 7, 2007); SEC-OGC Op. No. 18-07; SEC-OGC Op. No. 20-07; SEC-OGC Op. No. 21-07 (Nov. 28, 2007); SEC-OGC Op. No. 09-09 (Apr. 28, 2009); SEC-OGC Op. No. 42-11 (Oct 12, 2011).

[54] *See* SEC-OGC Op. No. 22-07 (Dec. 7, 2007).

nationalized or partly nationalized economic activities;[55] (2) when the Filipino ownership in a corporation is less than 60%;[56] and (3) when the law requires more than 60% of Filipino ownership in a partly nationalized industry.[57] Moreover, the SEC did not categorically and absolutely abandon the grandfather rule, and had only gone so far as to state that the Commission, on the basis of the 1989 DOJ Opinion, had "voted and decided to do away with the strict application/computation of the so-called 'grandfather rule' [...] and instead applied the so-called 'control test' method of determining corporate nationality."[58]

ii. Application of the Grandfather Rule in *Redmont*

The antecedents which led to the dispute in *Redmont* are the same as those in *Narra Nickel*. *Redmont* involved a complaint filed before the SEC to revoke the certificates of registration of certain mining corporations, including the petitioner corporations in *Narra Nickel*, on the ground that they failed to comply with nationality requirements under the Constitution and related statutes. Resolving the complaint, the SEC *en banc* declared that the grandfather rule applies, citing DOJ Opinion No. 20 (s. 2005) to support its decision. In Opinion No. 20, the DOJ reformulated the "doubt exception" it created in its 1989 Opinion[59] by illustrating that the grandfather rule applies "only when the 60-40 Filipino-foreign equity ownership is in doubt (i.e. in cases where the joint venture corporation with Filipino and foreign stockholders with less than 60% Filipino stockholdings [or 59%] invests in another joint venture corporation which is either 60-40% Filipino-alien or 59% less Filipino)."[60]

With the "doubt exception" in mind, the SEC proceeded to rule that doubt existed in the nationality of the mining corporations because their common stockholder, which was a foreign corporation, practically supplied all their funds. Therefore, the SEC essentially arrived at an independent determination of the existence of doubt when it went beyond the percentage of Filipino-foreign ownership and looked into the amount of capital actually contributed and controlled by a foreign stockholder. However, the SEC did not ultimately revoke the registrations of these mining corporations and

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[55] *See* SEC Op. No. 05-04-1987 (May 4, 1987).

[56] *See* SEC-OGC Op. No. 22-07 (Dec. 7, 2007).

[57] *See* SEC Op. No. 41-04 (Sept. 28, 2004).

[58] SEC Op. No. 05-30-1990 (May 30, 1990).

[59] *See* DOJ Op. No. 18 (s. 1989), where the DOJ broadly suggested that the grandfather rule "will not apply in cases where the 60-40 Filipino-alien equity ownership in a particular natural resource corporation is not in doubt."

[60] DOJ Op. No. 20 (s. 2005).

merely set aside the findings of one of its subordinate offices that the corporations were Philippine nationals. The SEC then dismissed the complaint for revocation, without prejudice, in deference to the Court of Appeals before which the same issue was already pending through a parallel case.[61]

iii. Reversion to the Control Test

Although there has been no reported SEC opinion or other issuance on the mining industry after *Redmont*, the SEC applied the control test to corporations seeking to acquire ownership of land—a right similarly restricted by the Constitution to corporations which are 60% Filipino owned.[62] Hence, far from doing away with the control test, the SEC has in fact continued to apply the same without also ruling out the application of the grandfather rule as in *Redmont*. Simply put, it appears that the SEC has not viewed *Redmont* as changing the rules the Commission has always applied.

Notably, however, there were also instances where the SEC refused to give an opinion on the issue of whether a corporation's ownership structure was compliant with the constitutional requirements, saying that a determination of which between the control test or the grandfather rule was applicable "would necessitate the determination of factual issues and should be the subject of a proper case or proceeding."[63]

D. The Tests as Applied in *Narra Nickel*

These SEC opinions were not considered by the Supreme Court when it decided the 2014 case of *Narra Nickel Mining and Development Corp. v. Redmont Consolidated Mines Corp.*

The dispute in *Narra Nickel* began when Redmont Consolidated Mines Corp. filed petitions to deny the applications for Mineral Production Sharing Agreements of the three petitioner-mining corporations—Narra Nickel Mining and Development Corp., Tesoro Mining and Development, Inc., and McArthur Mining Inc.—before the Panel of Arbitrators of the Department of Environment and Natural Resources. Redmont alleged that at least 60% of the capital stock of the petitioners were owned and

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[61] SEC-OGC Op. No. 20-10 (May 27, 2010), dispositive portion.

[62] *See* SEC-OGC Op. No. 20-10 (May 27, 2010); SEC-OGC Op. No. 23-10 (Aug. 18, 2010).

[63] SEC-OGC Op. No. 02-12 (Feb. 2, 2012).

controlled by a 100% Canadian corporation, and since the capital was largely controlled by the latter, the petitioners should be disqualified from engaging in mining activities. In response, the petitioners claimed that the control test embodied in Section 3(a) of the FIA should apply in determining their respective nationalities; applying this test, they were Philippine Nationals qualified to undertake in mining activities in the Philippines.

Disposing of the petitioners' argument that the control test under the FIA applies, the Court held that the intention of the framers of the Constitution was to apply the grandfather rule in cases where corporate layering is present. It then cited the following exchange in the deliberations of the 1986 Constitutional Commission:

> MR. NOLLEDO: Thank you.
>
> 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.[64]

Adopting the theory that the grandfather rule has basis in the Constitution, the Court noted that "specifically pertaining to the provisions under Art. XII of the Constitution on National Economy and Patrimony, [the control test in the FIA] will have no place of application."[65] The Court essentially held that since the control test was a test prescribed by a mere statute, it cannot prevail over the grandfather rule which is supposedly ordained by the Constitution, as evidenced by the deliberations of the Constitutional Commission.

In addition, the Court held that the grandfather rule applies when doubt exists as to the percentage of Filipino ownership in a corporation. The existence of doubt was based on the fact that the Canadian corporation practically invested all the funds of the petitioners. The Court held further that the qualification of the "doubt exception" in DOJ Opinion No. 20 (s. 2005) was merely an example or an instance where doubt exists, meaning

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[64] *Narra Nickel*, 722 SCRA at 416. (Emphasis supplied.)

[65] *Id.*

that the existence of doubt is not limited to cases when the percentage of Filipino ownership is less than 60%.

The petitioners filed a motion for reconsideration claiming that the Court's application of the grandfather rule was without basis in the Constitution, the FIA, the Philippine Mining Act of 1995, and the SEC Rules.[66] Hence, in the 2015 Resolution, the Court clarified that "nowhere in [the 2014 Decision] did the Court foreclose the application of the Control Test in determining which corporations may be considered Philippine nationals." [67] Therefore, the proper method in determining whether a corporation met the nationality requirements is to use the tests *cumulatively*—the grandfather rule, then, was to be applied *with* the control test. The Court expounded further that it is "only when the Control Test is first complied with that the Grandfather Rule may be applied." [68]

Meanwhile, the "doubt standard" adopted by the Court in its 2014 Decision was retained in its 2015 Resolution when the Court affirmed that "resort to the Grandfather Rule is necessary *if doubt exists* as to the *locus* of the 'beneficial ownership' and 'control.'" "Doubt," according to the Court, refers to "various indicia that the 'beneficial ownership' and 'control' of the corporation do not in fact reside in Filipino shareholders but in foreign stakeholders." [69]

The majority opinion in *Narra Nickel* was met with a dissent by Justice Leonen. It was the dissent's position that the "Grandfather Rule has no statutory basis" and that "[i]t is the Control Test that governs in determining Filipino equity in corporations."[70] The dissent questioned the interpretative value of the deliberations of the 1986 Constitutional Commission as basis for the ruling that the grandfather rule is enshrined in the Constitution. According to Justice Leonen, "the Constitutional Commission's deliberations notwithstanding, the 1987 Constitution was, ultimately, inarticulate on adopting a specific test or means."[71] Congress filled in this gap in the fundamental law by providing for the control test in the FIA as the governing rule.

The dissent likewise pointed out that aside from the lack of a statutory basis, the grandfather rule suffers from practical difficulties. The

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[66] *Narra Nickel*, at 4 (Res. Mot. Recon., slip opinion).
[67] *Id.*
[68] *Id.* at 12.
[69] *Id.* at 12-13.
[70] *Id.* at 440.
[71] *Id.* at 489.

exercise of ultimately tracing the nationality of equity to natural persons who hold rights to stocks is burdensome considering that it is common business practice to have corporate stockholders in a corporation. In other words, "the Grandfather Rule [...] will never be satisfied for as long as there is a corporation holding the shares of another corporation."[72] Another difficulty with the application of the grandfather rule is that ownership of stocks can change on a daily basis given that shares of certain corporations are listed and traded in stock exchanges.

II. CRITIQUING THE NARRA NICKEL OPINIONS

Having examined the state of the law as to the applicable test in determining the extent of foreign ownership in corporate stockholders, we now proceed to dissect the analysis of the Court in *Narra Nickel* and scrutinize its legal bases and its implications.

A. On According Administrative Findings Great Weight

In arriving at its decision, the Court relied on the factual findings of the appellate court and a number of administrative agencies. In particular, the Court was in agreement with the findings of fact of the Court of Appeals [CA], and also appeared to be in agreement with the SEC's findings in the *Redmont* case, although the latter did not directly figure in the dispute. In detail, the SEC looked into the factual circumstances amounting to the existence of doubt which warranted the application of the grandfather rule. The SEC noticed from the record that a foreign corporation practically invested all of the funds of the mining corporations.[73] After arriving at a determination that there was doubt, the SEC then proceeded to apply the grandfather rule by relying on two sources: DOJ Opinion No. 20 (s. 2005), and the deliberations of the 1986 Constitutional Commission.[74] The Court likewise reiterated the finding of the appellate court that "doubt is present in

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[72] *Narra Nickel*, at 503 (Res. Mot. Recon., slip opinion).

[73] SEC En Banc Case No. 09-09-177 (Mar. 25, 2010).

[74] On the one hand, DOJ Op. No. 20 was interpreted by the SEC as having laid down a guide that the grandfather rule applies when there is doubt. On the other, the deliberations of the 1986 Constitutional Commission were taken by the SEC as basis to support its conclusion that it was the intent of the framers to adopt the grandfather rule. Coincidentally, the Court also arrived at the same determination using the same instruments used by the SEC. *See* SEC En Banc Case No. 09-09-177 (Mar. 25, 2010).

the 60-40 Filipino equity ownership of [petitioner corporations], since their common investor, the [100% foreign owned corporation], funded them."[75]

We note with much caution, however, that the SEC *en banc* ruling cited by the Court, while founded on the same facts subject of the dispute before it, was not the act on *certiorari* before the Court; consequently, whatever facts from the SEC proceedings that were cited in the Court's decision were most likely facts as stated in the opinion of the Commission, and were not independently part of the record of the *Narra Nickel* case.

Meanwhile, the factual finding of the CA is its own determination of whether the petitioner corporations complied with the 60-40 Filipino-alien equity requirement using the grandfather rule. In ruling that the petitioners were foreign corporations, the CA "looked into their corporate structures and their corresponding common shareholders."[76] Such task necessarily entailed the reception or evaluation of evidence as to the proportion of ownership of the corporations' respective shareholders. The Court concurred with the CA that the petitioner corporations were foreign-owned and engaged in the similar exercise of identifying the amount of funds actually invested by the foreign corporation.[77]

There is a question of law "when there is doubt as to what the law is on a certain state of facts," while there is a question of fact "when doubt arises as to the truth or falsity of the alleged facts."[78] The common issue decided by the Court, the CA, and the SEC was whether doubt existed in the beneficial ownership and control of the petitioner corporations, such issue being a question of fact. In *Narra Nickel*, the resolution of whether a corporation is foreign-owned relied on two questions: (1) which test must be used to compute the Filipino-foreign equity in a corporation, and (2) what facts and figures illustrate the extent of beneficial ownership and control of Filipinos and foreigners in a corporation. To address the first question, the Court, in finding that the grandfather rule has basis in law, distilled a principle that such rule is applicable when there is doubt as to the Filipino-foreign equity in a corporation. Having clarified the appropriate legal principle, it proceeded to answer the second question and accordingly concurred, in effect, with the finding by the SEC that doubt existed in the

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[75] *Narra Nickel*, 722 SCRA at 402.

[76] *Id.*

[77] *See Narra Nickel*, 722 SCRA at 419, *et seq.*

[78] Velayo-Ong v. Spouses Velayo, G.R. No. 155488, 510 SCRA 320, 329, Dec. 6, 2006 *citing* Olave v. Mistas, G.R. No. 155193, 444 SCRA 479, 490, Nov. 26, 2004; Western Shipyard Services, Inc. v. Ct. of Appeals, G.R. No. 110340, 358 SCRA 257, 264, May 28, 2001.

Filipino-foreign equity, and affirmed the findings of the CA on the respective corporate structures of the petitioner corporations, as well as the appellate court's factual conclusion that the corporations were in fact foreign-owned.

In any event, *Narra Nickel* should be a model for greater reliance on the findings of fact-finding agencies, such as the SEC and the Department of Environment and Natural Resources [DENR] Panel of Arbitrators (if and when it looks into the corporate structures of mining corporations), insofar as the resolution of the *factual* questions is concerned. Findings of fact of administrative agencies are generally accorded great respect, if not finality, by the courts by reason of the special knowledge and expertise of said administrative agencies over matters falling within their jurisdiction.[79] As to the SEC, it was delegated the power to "[s]uspend, or revoke, after proper notice and hearing the franchise or certificate of registration of corporations, partnerships, or associations, upon any of the grounds provided by law."[80] Necessarily, it also has the power to appraise facts constituting a violation or non-compliance with the law and take appropriate administrative action if supported by substantial evidence. Considering that the DENR's mandate involves the supervision of mining activities,[81] the principle can be extended to the latter administrative agency.

B. On Imposing a Different Standard for Constitutional Restrictions

The Court declared that "specifically pertaining to the provisions under [Article XII] of the Constitution on National Economy and Patrimony, [Section 3] of the FIA will have no place of application."[82] Section 3 was therefore not declared unconstitutional, but the Court merely held that insofar as it interprets the Constitution's nationality requirements, the statute is inapplicable. In other words, the Court did not overrule Congress's determination of how foreign ownership should be reckoned in economic areas nationalized or partly nationalized by statute; however, because the particular restriction in *Narra Nickel* is enshrined in the Constitution itself,[83] then the Court is not bound by how Congress has interpreted the same requirement through the FIA.

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[79] Sps. Hipolito v. Cinco, G.R. No. 174143, 661 SCRA 312, Nov. 28, 2011.
[80] Rep. Act No. 8799 (2000), § 5(m). Securities Regulation Code.
[81] *See* Rep. Act No. 7942 (1995). Philippine Mining Act of 1995.
[82] *Narra Nickel*, 722 SCRA at 416.
[83] *Id.* at 413-4, *citing* CONST. art. XII, § 2.

This distinction is legally correct. It is axiomatic that the Court is the final arbiter of constitutional questions, [84] and while all branches of government interpret the Constitution on their own in the performance of their many functions,[85] their application of the basic law is almost always subject and subsumed to how the judiciary has chosen to read it.[86] This is not a novel hypothesis, and at least one proponent of the grandfather rule has previously encouraged the Court to adopt a stricter standard in areas reserved by the Constitution.[87] For now, without going into the soundness of the policy decision ultimately made by the Court, we submit that it was fully within the power of the judiciary to disregard the legislature's (and, through the FIA's more explicit implementing rules, the executive's) construction of how to calculate the foreign ownership of juridical investors simply because the Court was engaged in a direct interpretation of a Constitutional provision.

Furthermore, the Court's substitution of the legislature's interpretation of the Constitution is allowed in this case since this is not an issue which the Constitution left to the determination of the political branches. The text of the subject provision—Article XII, Section 3 of the Constitution—does not feature a proviso leaving its operation to Congress, which would have bound the Court to respect the legislative determination by applying it.

Hence, as regards Justice Leonen's dissent, which heavily relies on administrative and legislative issuances,[88] it is respectfully submitted that the said citations are only persuasive in character insofar as the interpretation of a constitutional—and not merely statutory—prohibition or injunction is required. While, as the contemporaneous construction of the other branches

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[84] *See* Angara v. Electoral Commission, 63 Phil. 139, 156-7. "It is the role of the Judiciary to define and, when necessary, correct constitutional (and/or statutory) interpretation, in the context of the interactions of the three branches of the government." Phil. Scout Veterans Security & Investigation Agency, Inc. v. Nat'l Lab. Rel. Comm'n, G.R. No. 99859, 262 SCRA 112, 121, Sept. 20, 1986. (Citations omitted.)

[85] In the process, the "other departments of government do make constitutional law, particularly with respect to questions deemed political." VICENTE V. MENDOZA, JUDICIAL REVIEW OF CONSTITUTIONAL QUESTIONS: CASES AND MATERIALS v (2004).

[86] *See, e.g.* Francisco v. House of Representatives, G.R. No. 160261, 415 SCRA 44, 151, Nov. 10, 2003, *citing* Baker v. Carr, 369 U.S. 186 (1962), for the political question exception.

[87] Reginald A. Dimacuha, *The Control Test in Determining Corporate Nationality: Drawing the Line Between Economic Areas Nationalized by the Constitution and Statutes*, 40 ATENEO L.J. 162, 194 (1995).

[88] *Narra Nickel*, 722 SCRA at 464 *et seq.* (Leonen, *J.*, dissenting).

of government, they *might* persuade a Court,[89] from a purely legal standpoint it was fully and legally within the Court's discretion *not* to be persuaded in this case.

C. On the Primacy of the Deliberations of the Constitutional Commission as an Aid in Construction

In ruling that the grandfather rule must apply, the Court relied primarily on the Constitutional Commission's deliberations on the concerned provisions. According to the Court, "[t]he deliberations in the Records of the 1986 Constitutional Commission shed light on how a citizenship of a corporation will be determined," and perusing the same, it was "apparent that it [was] the intention of the framers of the Constitution to apply the grandfather rule in cases where corporate layering is present."[90] The Court appeared to be convinced by the fact that this method was cited in the exchange between Commissioners Villegas and Nolledo, and was even supposedly "adopted" by the Committee which proposed this portion of the Constitution.[91]

Reliance on the deliberations of the Constitutional Commission as an aid in construing the basic law has been sanctioned by the Court in cases too numerous to enumerate.[92] The reasons for this adherence were explained in *Civil Liberties Union v. Executive Secretary*:

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[89] *See* AFP General Insurance Corp. v. Molina, G.R. No. 151133, 556 SCRA 630, June 30, 2008. "As an interpretation of a law by the implementing administrative agency, it is accorded great respect by this Court." *Id.* at 640. Note, however, that contemporaneous construction is often used when the court relies on an *administrative* interpretation of a *statutory* rule, "because of the respect due the government agency or officials charged with the implementation of the law, their competence, expertness, experience, and informed judgment, and the fact that they frequently are the drafters of the law they interpret." DANTE GATMAYTAN, LEGAL METHOD ESSENTIALS (2012). (Citations omitted.) That said, there appears to be no reason not to extend this rule of construction to the Constitution, given that most of the rationale will likewise apply.

[90] *Narra Nickel*, 722 SCRA at 414, 416.

[91] III RECORD CONST. COMM'N No. 55 (Aug. 13, 1986), *cited in Narra Nickel*, 722 SCRA at 416 n.42.

[92] *See, e.g.* Flores v. Drilon, G.R. No. 104732, 233 SCRA 568, 575-6, June 22, 1993, on the distinctions between CONST. art. IX-B, § 7, ¶ 1 and ¶ 2; Lambino v. Comm'n on Elections, G.R. No. 174153, 505 SCRA 160, 232, Oct. 25, 2006, on adopting American jurisprudence on peoples' initiative, particularly the rule that the petition must set forth the full text of the proposed amendment, even when such rules were not made explicit in the Constitutional provision (note, however, that the decision did not cite the particular discussion, in contrast with previous cases); Gonzales III v. Office of the President, G.R. No. 196231, 679 SCRA 614, 652-3, Sept. 4, 2012, on the intentional exclusion of the

> A foolproof yardstick in constitutional construction is the intention underlying the provision under consideration. Thus, it has been held that the Court in construing a Constitution should bear in mind the object sought to be accomplished by its adoption, and the evils, if any, sought to be prevented or remedied. A doubtful provision will be examined in the light of the history of the times, and the condition and circumstances under which the Constitution was framed. The object is to *ascertain the reason which induced the framers of the Constitution to enact the particular provision and the purpose sought to be accomplished thereby*, in order to construe the whole as to make the words consonant to that reason and calculated to effect that purpose.[93]

In the same case, however, the Court clarified that resort to the deliberations is not sanctioned in all cases, and that at best, the opinions of the framers are merely persuasive:

> While it is permissible in this jurisdiction to consult the debates and proceedings of the constitutional convention in order to arrive at the reason and purpose of the resulting Constitution, resort thereto may be had only when other guides fail as said proceedings are powerless to vary the terms of the Constitution when the meaning is clear. Debates in the constitutional convention "are of value as showing the views of the individual members, and as indicating the reasons for their votes, but they give us no light as to the views of the large majority who did not talk, much less of the mass of our fellow citizens whose votes at the polls gave that instrument the force of fundamental law. We think it safer to construe the constitution from what appears upon its face." *The proper interpretation therefore depends more on how it was understood by the people adopting it than in the framers' understanding thereof.*[94]

This brings us to what we submit are two shortcomings of the Court's decision.

First, the Court relied solely on the deliberations of the Constitutional Commission in justifying its use of the grandfather rule while ignoring other aids in construction—extrinsic or intrinsic to the

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deputies of the Ombudsman from the enumeration of impeachable officials. (Citations omitted.)

[93] Civil Liberties Union v. Exec. Sec., G.R. No. 83896, 194 SCRA 317, 325, Feb. 22, 1991. (Emphasis supplied, citations omitted.)

[94] *Id.* at 337-38. (Citations omitted.)

Constitution—that could have also been used. For instance, the Court could have resorted to a contemporaneous construction by looking at how the other branches of government interpreted the subject Constitutional provision. This would have led the Court to examine the acts of the executive and legislative branches over almost a three-decade period. Said acts, in turn, might better approximate the "views of the large majority who did not talk, much less of the mass of [citizens] whose votes at the polls gave that instrument the force of fundamental law."[95]

This last conjecture is not unwarranted, considering that among the three departments, the executive and the legislative, being the political branches who are responsible to the electorate,[96] would in theory better represent the people's response to what is essentially a question of policy. Had the Court applied a contemporaneous construction and in light of the aforementioned generally stable interpretation of the relevant administrative agencies, particularly the Securities and Exchange Commission, it is possible that a different result would have been reached.

It must be noted that reference to the deliberations of the Constitutional Commission, as explained in *Civil Liberties Union*, appears to be an aid of last resort.[97] While the Court has liberally relied on deliberations of the framers, there is nothing which establishes its primacy over other tools of construction.

Second, the Court's interpretation of the Constitution, even under the caveat in *Civil Liberties Union*, fixes its meaning to the time of its enactment. We believe it is imprudent for courts to rely so much on an originalist[98] interpretation of the Constitution, especially given that our constitution is rigid and inflexible. Whether the Constitution's meaning is permanently frozen as of its ratification seems to have never been the subject of debate in this jurisdiction—the Court appears to have always favored an originalist reading of the basic law as seen in the aids of construction it sanctions, particularly the resort to the intent of the framers. The Court could not have been clearer as in the above cited passages from

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[95] Civil Liberties Union v. Exec. Sec., G.R. No. 83896, 194 SCRA 317, 337, Feb. 22, 1991. (Citations omitted.)

[96] *See* Abakada Guro Party List v. Ermita, G.R. No. 168056, 469 SCRA 14, 186 n.43, Sept. 1, 2015 (Panganiban, *J.*, *separate*).

[97] "[R]esort thereto may be had only when other guides fail as said proceedings are powerless to vary the terms of the Constitution when the meaning is clear." *Civil Liberties Union,* 194 SCRA at 337.

[98] *See generally* Antonin Scalia, *Originalism: The Lesser Evil*, 57 U. CINN. L. REV. 849 (1989).

Civil Liberties Union. While in the United States, whether the debate between originalism and pragmatism is even worth having has been questioned by scholars who believe that both "promise more than they can deliver,"[99] there is at least no institutional bias for a stiff, static reading of the Constitution; moreover, reliance on the intent of the framers is at least treated with caution, if not suspicion.[100] Juxtaposing the Commission's almost 30 year-old deliberations on the economic provisions with the more recent expressed policy of the State to open up to foreign trade and investment (via the legislature's FIA, and the executive's assent to the ASEAN Integration[101]), the interest of a living Constitution might have been better served if it were read in a more relevant, contemporary light—a reading that will render the Constitution free from the "problem of obsolescence" which springs from the "limitations of human foresight."[102]

In any case, our point is the Court should not have so quickly limited itself to resorting to the record of the Commission in interpreting the provisions. Other aids might have led the Court to arrive at a choice that is more in line with how the Constitution is currently interpreted by the people whose continued collective consent is the reason for its existence.

III. WHICH TEST SHOULD BE USED?

A. Courts as Policy-Making Bodies

This portion begins with what is, at least in the Philippines, a seemingly controversial premise: in the exercise of their judicial functions, courts (and, in this case, the Supreme Court) are actually engaged in policy-making. On its face and unexamined, this sounds contumacious, as it appears to accuse courts of violating the separation of powers.[103] We make

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[99] Jeffrey Rosen, *Originalism and Pragmatism: False Friends*, 31 HARV. J. L. PUB. POL'Y 937, 937 (2008).

[100] Daniel A. Farber, *Legal Pragmatism and the Constitution*, 72 MINN. L. REV. 1331, 1338-1339.

[101] *See* Declaration on the ASEAN Economic Community Blueprint, *available at* http://www.asean.org/news/item/declaration-on-the-asean-economic-community-blueprint (last accessed June 9, 2015).

[102] RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 680 (2007).

[103] "Even with the best of motives, the Court can only interpret and apply the law and cannot, despite doubts about its wisdom, amend or repeal it. And while the judiciary may interpret laws and evaluate them for constitutional soundness and to strike them down if they are proven to be infirm, this solemn power and duty do not include the discretion to correct by reading into the law what is not written therein." Saguiguit v. People, G.R. No. 144054, 494 SCRA 128, 134, June 30, 2006. (Citations omitted.) Note, however, that the

no such claim and merely echo a long-standing observation: realistically speaking, in deciding cases—and, in this case, in interpreting the Constitution—courts are actually engaged in choosing between two or more conflicting policies.[104]

The practical import of being confronted with this premise is, in analyzing which test should be adopted by the judiciary in determining the extent of foreign ownership in juridical investors, consequences such as the stability of commercial relations, the consistency of court rulings, and the simplicity and effectiveness of the tests, can be properly considered. At the same time, we emphasize that despite the reality that courts ultimately engage in policy-making, the chosen policies must be within the bounds of the law and judicial power, and that a desired social policy is merely one of the tools for judicial decision-making (along with precedent, tradition, and legal text).[105] Courts cannot and should not act as third houses of Congress, and are limited to the areas still left undetermined by the political branches.

B. Should there be Different Tests for Constitutional and Statutory Restrictions?

One of the most valuable rulings in *Narra Nickel* is that as to the estimation of foreign equity, it matters whether the requirement is imposed by the Constitution or by statute. The logic and reasoning behind this distinction, as earlier explained, is that when the restriction is imposed by the Constitution itself, the legislative interpretation in the form of a statute cannot unseat the Court from its role as the final arbiter, and, therefore, interpreter, of Constitutional questions.

In *Narra Nickel*, the restrictions were embodied in the Constitution, hence Congress's interpretation was merely persuasive. The case would have

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"wisdom" which courts do not interfere with is that of the political branches; the courts themselves are not precluded from deciding cases with wisdom.

[104] *See* Robert A. Dahl, *Decision-Making in a Democracy: The Supreme Court as a National Policy-Maker*, 6 J. PUB. L. 279 (1957). Dahl begins his seminal paper with the following: "To consider the Supreme Court of the United States strictly as a legal institution is to underestimate its significance in the American political system. For it is also a political institution, an institution, that is to say, for arriving at decisions on controversial questions of national policy." *Id.* at 279.

We believe this extends to the Philippine Supreme Court, which is not only molded after its US counterpart, but even has expanded judicial review under the Constitution, CONST. art. VIII, § 1, which has allowed it to decide questions which would other be classified as political and therefore incapable of review by the courts, *see generally* Francisco v. House of Representatives, 415 SCRA 44, 151.

[105] Farber, *supra* note 100 at 1332.

been different had the requirement been statutory, in which case the way Congress determined how the qualification should be satisfied should control. Therefore, if a certain industry under the FIA or any statute regulating foreign ownership is circumscribed under the Constitution, the tests prescribed by that statute would not necessarily apply.

The question, then, is whether there *should* be different tests for constitutional and statutory restrictions. This requires us to answer two subquestions. First, despite the pronouncement in *Narra Nickel* that Section 3 of the FIA was inapplicable to the foreign equity restrictions embodied in the Constitution,[106] is the test in *Narra Nickel* in fact different from that provided in the statute? Second, if the test were indeed different, would it not have been better for the Court to simply adopt the test laid out by Congress? The first subquery requires us to examine the novelty, if any, of the *Narra Nickel* formulation; the second requires us to assess the policy decision made by the Court in promulgating the *Narra Nickel* test.

As to the first subquestion, we submit that *in operation*, the *Narra Nickel* test is similar to the formulation of the "control test" of the SEC in that both consist of two stages. However, the significant modification introduced by *Narra Nickel* is the use of "doubt" as an additional "trigger" to the application of the grandfather rule. To reiterate: whereas under the SEC's control test, the grandfather rule would be used when the percentage of foreign ownership was below 60% of the subject corporation, *Narra Nickel* adds this occasion of "doubt" as an additional ground for the application of the grandfather rule. Meanwhile, the *Narra Nickel* test is even more different from the test in Section 3(a) of the FIA, and probably the "control test" as mentioned in the FIA IRR. Significantly, the FIA's test does *not* contain a proviso embodying the grandfather rule, quite unlike the tests as phrased by the SEC, the DOJ, and the Supreme Court.

C. Which Test for Which Policy?

Having established that the *Narra Nickel* test is different from the test laid by Congress in the FIA, we now offer our nuanced positions as to whether the Court, as a matter of policy, should have simply deferred to the legislative formulation of how the extent of foreign ownership is determined. In doing so, we compare the various tests in light of criteria which we believe are important in this particular policy decision.

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[106] *Narra Nickel*, 722 SCRA at 416.

1. Which test would be sanctioned by the text of the Constitution?

Of the many foreign equity restrictions in the Constitution, there is none which provides for *how* exactly the extent of foreign ownership should be calculated. In interpreting the provisions, therefore, the Court could have gone with any test it saw fit. As such and as earlier explained, it was a policy decision on the part of the Court to choose the current formulation based on *Narra Nickel*. In arriving at that policy, the Court applied its own understanding of what the Constitution requires and chose to rely on the grandfather rule as it figured in the exchange between two members of the Constitutional Commission. Yet, pragmatically speaking, the court could have chosen either test without going beyond the limitations of its judicial power. It would, to use very familiar terms, merely fill in the gaps in the law.

2. Which test would be in line with the policy of the law of protecting Filipino control over nationalized industries?

The grandfather rule as applied in *Narra Nickel* would better serve the purpose of ensuring Filipino ownership on the premise that the Constitution favors a protectionist policy over a liberalized economy and if the test is indeed applied in cases of doubt. The policy of the law in protecting Filipino control is "to ensure that corporations or associations allowed [...] to exploit natural resources shall be controlled by Filipinos."[107] While it has uniformly and consistently applied the control test as previously discussed, the SEC favored the grandfather rule in a 2010 Opinion which said that "the control test must not be applied in determining if a corporation satisfies the Constitution's citizenship requirements in certain areas of activities."[108] Moreover, its succeeding opinions would cite the text of a 2005 DOJ Opinion which would describe the grandfather rule as a "strict rule" in stark contrast to the control test, which it found as a "liberal rule."[109] Notwithstanding the SEC's reversion to the control test after the Commission *en banc*'s ruling in *Redmont*,[110] the grandfather rule received recognition from the SEC as a tool to protect and preserve a Filipino-controlled market and to forestall any indicia of direct or indirect majority

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[107] Register of Deeds v. Ung Siu Si Temple, 97 Phil. 58 (May 21, 1955).

[108] SEC-OGC Op. No. 31-10 (Dec. 9, 2010).

[109] DOJ Op. No. 20 (s. 2005), *cited in* SEC-OGC Op. No. 13-12 (Aug. 9, 2012); SEC-OGC Op. No. 02-12 (Feb. 2, 2012); SEC-OGC Op. No. 23-10 (Aug. 18, 2010); SEC-OGC Op. No. 26-11 (Apr. 19, 2011); SEC-OGC Op. No. 44-11 (Oct. 27, 2011).

[110] *See* SEC-OGC Op. No. 20-10 (May 27, 2010); SEC-OGC Op. No. 23-10 (Aug. 18, 2010).

influence by foreign investors over the Philippine economy. That the grandfather rule targets the percentage ownership of individual stockholders across stacks of corporate layers would indicate that it ensures Filipino control in every level of the corporate structure.

However, we must bear in mind that the grandfather rule, in the course of its application, remains a mere computational method to determine the actual percentage ownership of foreigners in a corporation. Hence, it is not a fail-safe way to ensure Filipino ownership. What is material is the purpose behind the law considered by a court or administrative agency in choosing a test, and so the factors which impel the decision to favor a test must be grounded on the policy they seek to uphold. The danger of resorting to a mechanical application of the test is seen in a 1987 SEC opinion which applied the grandfather rule in favor of an alien on the sole ground that the corporation was "engaged in partly nationalized economic activities."[111] It was noted that this opinion "justified a situation where aliens, not Filipinos, have effective control of the corporation."[112] Moreover, the Commission's reasoning that mere investment in a nationalized industry would warrant the application of the grandfather rule would be similarly applicable if it chose to apply the control test: was not the control test similarly created to ascertain the qualifications of corporations engaged in a nationalized industry?

We recommend that the *purpose* behind the Constitutional and statutory limitations on foreign ownership, as ascertained by the Court in *Narra Nickel*, must be considered a key factor in deciding which test to apply. Therefore, the "grandfather rule should not be applied in a situation where, by its application, foreign control of a domestic corporation is maintained over the nominally majority Filipino interests[.]"[113]

3. Which test would be in line with other policy considerations?

Because the text does not sanction any particular test, a number of other tools or, more properly, factors could have been considered by the

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[111] SEC Op. No. 05-04-1987 (May 4, 1987). Silahis International Hotel was 69% owned by Hotel Properties Inc., the latter corporation having a majority foreign equity of 53%. Ruling on the question of whether Silahis meets the nationality requirements, the SEC opined that Silahis is a Filipino corporation using the grandfather rule.

[112] Silverio Benny Tan, *The Grandfather Rule in Corporate Share Ownership*, 17 J. INTEG. BAR. PHIL. 7, 12 (1989).

[113] *Id.* at 14.

Court in crafting the method of determining foreign equity restrictions in the Constitution.

In terms of *stability* in Philippine law, the grandfather rule will likely forward this consideration. As earlier explained, the *Narra Nickel* approach is actually similar to how the SEC and DOJ compute foreign ownership (and differ only as to when the grandfather rule is triggered).

However, in considering the *harmony* of legal systems, it appears that the FIA's test is more appropriate. By imposing a 60% threshold, the evident intent of the law seems to be to count as Philippine nationals only those corporations that could be *controlled* by Filipino citizens. This focus on control versus naked ownership has been adopted by other jurisdictions. For instance, under the Investment Canada Act, "Canadians" means "(a) a Canadian citizen, (b) a permanent resident [...], (c) a Canadian government, whether federal, provincial or local, or an agency thereof, or (d) *an entity that is Canadian-controlled.*" [114] "Canadian-controlled," meanwhile, includes corporations where (a) "one *Canadian* or two or more members of a voting group who are Canadians *own a majority of the voting interests of an entity*," or (b) "a *majority of the voting interests of an entity are owned by Canadians* and it can be established that the *entity is not controlled in fact through the ownership of its voting interests* by one non-Canadian or by a voting group in which a member or members who are non-Canadians own one-half or more of those voting interests of the entity owned by the voting group."[115] While ownership figures in the determination of control, the overriding concern remains to be control-in-fact.[116]

Meanwhile, in the United States, only a US citizen may be given a certificate of public convenience to provide air transportation.[117] A "citizen of the United States" is defined as "a corporation or association organized under the laws of the United States or a State, the District of Columbia, or a territory or possession of the United States, of which the president and at

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[114] Investment Canada Act, R.S.C. 1985, c. 28 (1st Supp.), § 3. (Emphasis supplied.)

[115] § 26. (Emphasis supplied.)

[116] We note that in Canada, "[c]ertain sectors of the Canadian economy have industry-specific restrictions on foreign ownership that operate concurrently with the [Investment Canada Act]." Lawson A. W. Hunter, et al., *A Guide to Navigating Canada's Foreign Ownership Laws for New Investors,* 8(1) COMPETITION L. INT'L 37, 39 (2012). There are also industry-specific limitations on foreign ownership and investment. These sectors include the broadcasting sector, the communications sector, the financial services sector, the transportation sector, and other sectors such as "book publishing and selling, collection agencies, engineering, farming, fisheries, liquor sales, mining, oil and gas, optometry, pharmacies and securities dealers[.]" *Id.* at 39-40.

[117] 49 U.S.C. § 41102(a).

least two-thirds of the board of directors and other managing officers are citizens of the United States, which is *under the actual control of citizens of the United States*, and in which *at least 75 percent of the voting interest is owned or controlled by persons that are citizens of the United States.*[118] The US Department of Transportation[119] proposed a rule interpreting "actual control" to be based on the following indicators: (1) supermajority or disproportionate voting rights; (2) negative control/power to veto; (3) buyout clauses; (4) equity ownership; (5) significant contracts; (6) credit agreements/debt; and (7) family relationships/business relationships.[120] This leads us to see that equity ownership is only one among many considerations in determining whether a corporation engaged in the air transportation industry is under the "actual control" of US citizens.

Finally, as to the *practicality of application*, it appears that the FIA test is more workable. For public corporations today, shares are traded by the second in exchanges all over the world, making it difficult to ascertain the foreign equity in a Philippine corporation as of any given moment, especially in the face of corporate layering. A test which cannot be applied with ease at any given point is an exercise in futility since the test itself would accommodate circumvention, thereby rendering any policy it seeks to forward unattainable. The problem is magnified when the corporation is public but only minimally compliant, i.e. its foreign ownership only skirts the limit. In this last case, there are likely innumerable instances when the 60-40 rule is breached by the mere sale or transfer of a few shares in the market. On the other hand, a test which places a premium on the effective control of a corporation is likely easier to implement, and, therefore, more effective. Unlike ownership, control over a corporation, through its board of directors, takes a longer time to shift and occurs in moments, such as an annual election of directors, that have concomitant reportorial requirements.[121]

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[118] 49 U.S.C. § 40102(a)(15)(C). (Emphasis supplied.)

[119] *See* 49 U.S.C. § 41102. The Secretary of Transportation has the power to issue a certificate of public convenience to engage in the air transportation industry, and determines an applicant's fitness and compliance with the legal requirements.

[120] US Department of Transportation Advance Notice of Proposed Rulemaking, 68 Fed. Reg. 44675-75 (proposed July 30, 2003), *available at* http://www.gpo.gov/fdsys/pkg/FR-2003-07-30/pdf/03-19455.pdf (last accessed June 12, 2015).

[121] In the Philippines, Corporations are required by the SEC to submit a general information sheet. *See e.g.* SEC, Memo. Circ. No. 15 (s. 2006) [Guidelines on Compliance by Foreign Corporations on Reportorial and Monitoring Requirements]. *See also* CORP. CODE, § 26, requiring corporations (through its secretary or any other officer) to report to the SEC the names, nationalities and residences of the directors, trustees, and officers elected within 30 days after their election.

The impracticalities of monitoring ownership have been noted in the nationality requirements for US coastwise vessels, which also assume "that it is possible to determine with some degree of certainty the citizenships" of shareholders.[122] This is despite the fact that "the identities of the owners of public corporations are shrouded in mystery, even though every corporation is required by law to keep a record of its shareholders. Modern trends in share ownership have created an enormous disconnect between the actual purchasers of corporate shares, called economic or beneficial owners, and the legal owners of the shares under state corporate law, called record owners."[123] It was likewise pointed out that the problem is greater when the shareholders are institutions or corporations.[124]

CONCLUSION

Notwithstanding the Court's definitive choice in applying the grandfather rule in *Narra Nickel*, the question of which test applies will likely remain contentious as its resolution is affected both by deeply held nationalistic policies in our national law and by the liberal foreign investment climate in a globalized economy. The impact of *Narra Nickel* on the foreign investment policy of the Philippines will be felt the most in the SEC, the administrative agency which implements and monitors compliance with the nationality requirements of investor corporations. The SEC has had the occasion to apply the "doubt standard" as affirmed by the Court in *Narra Nickel*. However, the Court's reasoning—together with the FIA, its Implementing Rules, and other related laws—will form part of the legal bases adopted by the SEC in arriving at its conclusions.

There are various policy considerations that a court or an administrative agency may consider in applying a test and, as we have suggested, it may choose to apply a different test depending on the circumstances. In fact, the Court was clear in *Narra Nickel* that it did not foreclose the application of the control test and suggested that it be applied cumulatively with the grandfather rule. Despite our misgivings in its originalist interpretation of the fundamental law, the Court, as the final arbiter of constitutional questions, was exercising its judicial powers within the limits provided by the basic law in applying the grandfather rule to

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[122] Daniel Michaeli, Note, *Foreign Investment Restrictions in Coastwise Shipping: A Maritime Mess*, 89 N.Y.U. L. REV. 1047, 1056 (2014).

[123] *Id.* at 1056-7.

[124] *Id.* at 1064.

determine a circumvention of a foreign ownership restriction embodied in the Constitution.

Narra Nickel will not be the last case on the determination of foreign equity participation in investor corporations. The Court's act in favoring a policy in *Narra Nickel* will not end the public debate essentially on how the Constitution must be read. But short of a constitutional amendment that will either change the foreign equity restrictions or set out in more explicit terms how compliance with these restrictions is met, administrative agencies must rely on *Narra Nickel* in the performance of their respective functions. Meanwhile, members of the business community and the investing public must have a firm understanding of what the ruling says and does not say in order to make cost-efficient and optimal commercial decisions.

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