CREDITORS IN CONTROL: THE EXERCISE BY CREDITORS OF CORPORATE CONTROL THROUGH LOAN AGREEMENTS*

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ABSTRACT

The 1987 Constitution espouses a simple economic philosophy: "[t]he State shall develop a self-reliant economy effectively controlled by Filipinos." As operationalized in Philippine laws and jurisprudence, this constitutional command is premised upon the presumption that "control" can only be exercised through "capital." Thus, the current regulatory framework focuses on control exercised through voting stock, securities, or other complex transactions. In reality, however, innovations and advances in finance and contract law are eroding the traditional notion that control is exercised through "capital." It is possible for corporate control to be exercised through debt instruments. A litany of ways exist through which creditors can exercise control over corporate decision-making. The differences in method lie in who exercises the control-mechanisms, how the mechanisms are exercised, and when they are exercised. Do these transactions undermine the constitutional policy granting control of corporations engaged in nationalized and partially nationalized activities to Filipino nationals? Are there other complex debt transactions that permit its circumvention? Does the current regulatory regime render them illegal? If not, what regulatory measures should be introduced to address their use?

"[A]n overriding economic goal of the 1987 Constitution: to 'conserve and develop our patrimony' and ensure 'a self-reliant and independent national economy effectively controlled by Filipinos'."

– Justice Antonio T. Carpio[1]

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INTRODUCTION

The 1987 Constitution espouses a simple economic philosophy: "[t]he State shall develop a self-reliant economy effectively controlled by Filipinos."[2] This is operationalized by the simple and innocuous language of several corporate nationality clauses which require that at least X *per centum* of the capital of corporations be owned by Filipino citizens.[3] This presupposes that both economic and control rights belong to Filipino nationals.[4] The former pertain to the ability of a share of stock to yield monetary gains for the stockholder,[5] while the latter concern the power of a stockholder to influence corporate policy.[6]

The constitutional policy presumes that "control" can only be exercised through "capital." Thus, the current regulatory framework focuses on control exercised through voting stock and securities signifying ownership or equity. In reality, however, innovations and advances in finance and contract law are eroding the traditional notion that control is exercised through "capital." It is possible for corporate control to be exercised through debt instruments. This theory is based on the "Hidden Control" principle, defined as the vesting of voting control over the election of the Board of Directors and other major corporate decisions to Filipino nationals, but *de facto* control on key areas of corporate governance to foreigners exercised through credit.[7] In short, a Filipino stockholder holds

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[1] Gamboa v. Teves [hereinafter "*Gamboa Decision*"], G.R. No. 176579, 652 SCRA 690, June 28, 2011.

[2] CONST. art. II, § 19.

[3] *See, e.g.* CONST. art. XII, § 11. "No franchise, certificate, or any other form of authorization for the operation of a public utility shall be granted except to citizens of the Philippines or to corporations or associations organized under the laws of the Philippines, at least sixty per centum of whose capital is owned by such citizens."

[4] Heirs of Gamboa v. Teves [hereinafter "*Gamboa Resolution*"], G.R. No. 176579, 682 SCRA 397, Oct. 9, 2012.

[5] Siddharth Ranade, *Separation of Voting Rights from Cash-Flow Rights in Corporate Law: In Search of the Optimal*, Warwick School of Law Research Paper No. 2013/07 (2013), *available at* http://ssrn.com/abstract=2246757.

[6] Liping Dong, Konari Uchida & Xiaohong Hou, *How Do Corporate Control Rights Transactions Create Shareholder Value? Evidence from China*, Asian Finance Association 2014 Conference Paper (2014), *available at* http://ssrn.com/abstract=2396514

[7] Hu and Black defined Hidden Control as one that can be exercised through both equity and credit instruments. For the purposes of this Note, the concept of "Hidden Control" will only be tackled from the perspective of credit. *See* Henry T.C. Hu & Bernard Black, *Hedge Funds, Insiders, and the Decoupling of Economic and Voting Ownership: Empty Voting*

majority of the voting rights in the election of directors, but a foreign investor holds actual control in fundamental matters and other submitted matters of the Filipino corporation;[8] thus, there is power and control *without any* voting rights.

Under the Hidden Control principle, there is an apparent compliance with the control requirements of the Constitution. To illustrate, consider the following scenarios:

1. Filipino stockholders hold a majority of the position in the Board of Directors in a corporation engaged in partially nationalized activities, among others. A foreigner holds a minority position.

   To infuse more capital, the foreigner stockholder executes a Loan Agreement with the corporation. The loan provides a Covenant which stipulates that the foreigner-creditor may veto the sale of a substantial number of assets of the corporation. Likewise stipulated, the creditor can choose to declare the debt outstanding in case of default.

   Majority of the Board of Directors decide to limit the corporation's business activities to Luzon and wind up its operations in the Visayas and Mindanao. Consequently, the Board of Directors resolves to sell all their assets in Visayas and Mindanao. The foreigner sends a Notice of Default and vetoes the sale. The foreigner argues that the sale of the Visayas and Mindanao assets constitutes a "sale of a substantial number of assets of the corporation."

2. A Filipino stockholder holds a majority of the positions in the Board of Directors in a corporation engaged in nationalized activities.

   The total capitalization is not sufficient to operate the business of the corporation. Thus, the corporation seeks additional capital through the issuance of Convertible Subordinated Notes. The indenture on the Notes provides

and Hidden (Morphable) Ownership, 14 J. CORP. FIN. 343 (2007), *available at* http://papers.ssrn.com/abstract=874098.

[8] *See* Brian Studniberg, *The Concept of De Facto Control in Canadian Tax Law: Taber Solids and Beyond*, 54 CAN. BUS. L.J. 17 (2013).

an obligation for the corporation to repurchase the Notes at par value in case of "fundamental changes." A foreigner purchases the Notes.

The corporation enters into a merger agreement with another corporation. The foreigner-creditor sends a Notice of Default and threatens to stop the merger until the Notes are repurchased at par. The notes are currently trading at a value under par.

3. A Filipino stockholder holds a majority of the total capital stock and majority of all the voting shares in a corporation engaged in partially nationalized activities. A foreigner holds the minority position.

   The total capital is insufficient to sustain the operation costs of the corporation. Consequently, additional capital is received through the execution of a Loan Agreement with the foreigner. The loan provides a Covenant that requires that dividends accruing to shares of stock be transferred to a trust fund. The dividends can only be released to share holders upon the occurrence of certain "trigger events" as stipulated in the loan agreement. The corporation is unable to pay the loan.

From the point of view of both fact and law, all three scenarios are compliant with the current regulatory framework. Notably, when assessed from the lens of the *Gamboa* Control Test,[9] Filipinos exercise control over the corporation by virtue of the majority position in the Board; likewise, Filipino nationals own majority of the total capital stock and majority of all voting shares. Nothing, however, is what it seems. A closer scrutiny of the above-discussed scenarios would reveal that, while Filipino nationals exercise *de jure* control, the foreign investor's credit position and acceleration option permit him to exercise *de facto* control on key managerial decisions. Thus, the following observations can be made:

1. Under the first scenario, two salient features will be observed from the Loan Agreement: first, the creditors possess veto prerogatives over corporate discretion with respect to the disposition of its assets; second, in case of default, the creditor may accelerate the loan. Notably, the

[9] *Gamboa Resolution*, 682 SCRA at 418.

corporation is heavily leveraged in favor of a foreign minority stockholder.

The foreigner-investor will be unable to prevent the downsizing of the operations of the corporation by the exercise of his voting rights. However, because of the provisions of the Covenant in the Loan Agreement, he will, nonetheless, be able to block the sale of the corporation's assets in Visayas and Mindanao. Thus, the foreigner is able to do indirectly, through the exercise of rights under the Loan Agreement, what he cannot otherwise achieve through the use of voting rights.

2. In the second scenario, the corporation is heavily leveraged in favor of the foreigner. The indenture obligates the corporation to repurchase the Notes at par in case it undergoes a "fundamental change." One such fundamental change is a merger. Generally, when a company undergoes a merger, it signals that is it under financial distress.[10]

   The Note holders, because of the indenture, can effectively veto the merger unless the obligation under the Notes is complied with. Because of the financial condition of the corporation, it is likely that they will be unable to comply; thus, a renegotiation will likely ensue. This allows the foreigner-creditor to participate in, effect changes to, or otherwise influence the merger.

   Demonstrably, therefore, in renegotiation scenarios, there is a high probability that the control exercised by the foreign creditor increases especially if the corportion is under dire financial straits.[11] Notably, the renegotiation of the loan is akin to a stockholder's meeting.[12]

3. With respect to the third scenario, the Filipino stockholder maintains *de jure* control over the corporation. However, a combination of the provisions of the covenant, the amount

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[10] *See* Greg Nini, David Smith & Amir Sufi, *Creditor Control Rights, Corporate Governance, and Firm Value*, 25 REV. FIN. STUD. 1713 (2012).

[11] Hu & Black, *supra* note 7.

[12] David Denis & Jing Wang, *Debt Covenant Renegotiations and Creditor Control Rights*, 113 J. FIN. ECON. 348 (2013), *available at* https://ssrn.com/abstract=2317941.

> of the loan, and the financial position of the corporation results in *de facto* control by the foreigner. The latter is able to do this through "trigger events" that permit the foreign creditor to exercise through Covenant rights corporate decisions which he cannot achieve through a majority vote.

Do these transactions undermine the constitutional policy granting control of corporations engaged in nationalized and partially nationalized activities to Filipino nationals? Are there other complex debt transactions that permit its circumvention? Does the current regulatory regime render them illegal? If not, what regulatory measures should be introduced to address their use?

To answer these questions, this Note undertakes three objectives:

Part I of this Note discusses the following: (1) the traditional notion of how control is exercised, (2) how debt instruments have eroded the traditional mode of exercising control, (3) the means and methods of achieving creditor control of corporations, and (4) the meaning of separation of control in law and control in fact.

Part II begins by expounding on the limitations of prevailing control tests under statutes and jurisprudence. It will then proceed to present and analyze concrete examples of creditor control mechanisms discussed in Part I.

Part III proposes a new regulatory measure to address the phenomenon of foreign creditor-control mechanisms in corporations engaged in nationalized and partially nationalized economic activities.

I. CREDITOR CONTROL MECHANISMS

A. Traditional and Modern Notions of Control

It is argued that corporate governance "deals with the ways in which the suppliers of finance to corporations assure themselves of getting a return on their investments."[13] This definition leads us to the question of *which* investors exert control over managerial decision-making to assure good returns? The traditional view in corporate finance maintains that equity

[13] *See* Andre Shleifer & Robert Vishny, *A Survey of Corporate Governance,* 52(2) J. FIN. 737 (1997), *available at* https://ssrn.com/abstract=100528.

holders possess the right to control the actions of a corporation.[14] Corporate governance scholars ratiocinate that it is only equity claimants who possess the appropriate incentives to make proper discretionary decisions because they absorb the risks and rewards attributable to decision-making.[15] This proceeds from the notion that equity claimants, as the ultimate "owners," dictate corporate policy and action in such manner as to manage those marginal economic gains and losses.[16] Typically, shareholders exercise the power to direct managerial decision-making, directly or indirectly, through the board of directors.[17]

This traditional view is reflected in both Philippine jurisprudence and statutory law. In *Gamboa v. Teves*,[18] the Supreme Court formulated the "Control Test" which requires that both beneficial ownership and voting control must vest in the hands of Filipino nationals. Under this test, beneficial ownership of X *per centum* of the outstanding capital stock coupled with X *per centum* of the voting rights must belong to Filipinos.[19] Closely related to the Control Test, and applied suppletory, is the "Grandfather Rule," which was defined by the Court in *Narra Nickel Mining and Development Corp. v. Redmond Consolidated Mines Corp.*,[20] as:

> [T]he method by which the percentage of Filipino equity in a corporation engaged in nationalized and/or partly nationalized areas of activities, provided for under the Constitution and other nationalization laws, is computed, in cases where corporate shareholders are present, by attributing the nationality of the second or even subsequent tier of ownership to determine the nationality of the corporate shareholder.[21]

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[14] *See* Greg Nini, David C. Smith & Amir Sufi, *Creditor Control Rights and Firm Investment Policy*, Sept. 2006, *available at* https://www.fdic.gov/bank/analytical/cfr/2006/oct/nss.pdf.

[15] *See* Shaun Martin & Frank Partnoy, *Encumbered Shares*, 3 U. ILL. L. REV. 775 (2005).

[16] Mike Burkart & Samuel Lee, *The One Share - One Vote Debate: A Theoretical Perspective,* ECGI – Finance Working Paper 176 (2007), *available at* http://ssrn.com/abstract=987486.

[17] II JOSE CAMPOS, JR., THE CORPORATION CODE 263 (1999).

[18] *Gamboa Resolution*, 682 SCRA 397.

[19] Note that the percentage "X" is determined by law. *See* SEC Memo. Circ. No. 8 (2013), § 2. *See also* CONST. art. XII, § 11. "No franchise, certificate, or any other form of authorization for the operation of a public utility shall be granted except to citizens of the Philippines or to corporations or associations organized under the laws of the Philippines, at least sixty per centum of whose capital is owned by such citizens."

[20] Hereinafter "*Narra Nickel*", G.R. No. 195580, 748 SCRA 455, Jan. 28, 2015.

[21] *Id.* at 466, *citing* CESAR L. VILLANUEVA, PHILIPPINE CORPORATE LAW 54 (2001).

Philippine statutory law, on the other hand, requires compliance with the Anti-Dummy Act.[22] The law proscribes two things: *first*, the participation of individuals, nationals or foreigners, in evading nationalization laws;[23] and *second*, the intervention of foreign nationals in the management, operation, administration, or control of any nationalized activity.[24] The Department of Justice (DOJ) has identified the following as "significant indicators" or badges of "dummy status":

> 1. That the foreign investor provides practically all the funds for the joint investment undertaken by Filipino businessmen and their foreign partner[;]
> 2. That the foreign investors undertake to provide practically all the technological support for the joint venture[; and]
> 3. That the foreign investors, while being minority stockholders, manage the company and prepare all economic viability studies.[25]

It is immediately apparent that the existing regulatory framework seeks to address primarily the circumvention of constitutional and statutory control and nationality requirements through various securities and other complex contractual arrangements. This is consistent with the traditional view of corporate governance. It is premised upon the belief that stockholders ultimately steer corporate policy direction and presumes that creditors remain mum and indifferent to managerial decision-making outside payment default states.[26]

However, recent literature suggests that creditors exert substantial influence over managerial decision-making outside payment default states. In other words, credit holders begin to play an active role in governance and control when credit quality or firm performance deteriorates but well before a corporation is in danger of bankruptcy.[27]

In a 2006 study, researchers documented a steep global increase in private credit agreements wherein banks and other lending institutions place

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[22] Com. Act No. 108 (1936).

[23] § 2.

[24] § 2-A.

[25] Op. of the Sec. of Justice 165 (Nov. 2, 1984). *See Narra Nickel*, 748 SCRA at 503 (Leonen, *J.*, *dissenting*).

[26] Denis & Wang, *supra* note 12.

[27] Peter Feldhütter, Edith Hotchkiss & Oguzhan Karakas, *The Impact of Creditor Control on Corporate Bond Pricing and Liquidity*, Mar. 4, 2014, *available at* https://www.hhs.se/contentassets/72cad454b143403ab1047c00f769802c/karakas_the-impact-of-creditor-control.pdf.

explicit restrictions in capital expenditures.[28] Corollarily, it is observed that such capital expenditure restrictions ultimately lead to creditor-imposed limitations on corporate investment policy under the premise that such stipulations serve as a hedge against value-destroying behavior by managers.[29] In a 2008 update on the aforementioned study, it was determined that creditor-imposed investment policy restrictions increase when the borrower's credit quality deteriorates.[30]

Recent literature demonstrate that creditors exercise control through the imposition of debt covenants.[31] In this regard, creditor control rights become pronounced in two instances: *first,* when there is a covenant violation; and *second,* when there is an impending covenant violation. A 2011 survey revealed that following convenant violations, creditors are able to negatively influence acquisition and capital expenditures, restrict leverage and shareholder payouts, and effect CEO replacement.[32] In 2013, corporate governance scholars observed that creditors exercise substantial control of corporate policy during debt renegotiations that partake of a similar form to shareholder or board meetings.[33] The study revealed a strong downward shift in the borrower's investment and financial policies during post-renegotiation scenarios.[34]

Creditors, thus, draw from a deep toolkit of contractual arrangements that enable them to control, restrict, and influence any dimension of corporate investment and financial policy, as well as managerial policy. These restrictions apply to all firms across the credit-quality spectrum, and are imposed long before a firm is in danger of bankruptcy.

B. Control in Law and Control in Fact

Since the Philippine constitutional policy focuses on "control" exercised through "capital" or equity, foreigners ingeniously circumvent the control limitation by focusing their resources on debt instruments. There are a number of ways through which creditors can exercise control over firm

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[28] Nini, Smith & Sufi, *supra* note 14.

[29] *Id.*

[30] *See* Greg Nini, David C. Smith & Amir Sufi, *Creditor Control Rights and Firm Investment Policy,* 92 J. FIN. ECON. 400 (2009), *available at* http://pdfs.semanticscholar.org/b8b9/c0d278895f725d9eb553896b83eb75a05cd6.pdf.

[31] Feldhütter, Hotchkiss & Oguzhan Karakas, *supra* note 27.

[32] Nini, Smith & Sufi, *supra* note 10.

[33] Denis & Wang, *supra* note 12.

[34] *Id.*

decision-making as there is no one fixed methodology. The differences lie in who exercises the control-mechanisms, how the mechanisms are exercised, and when they are exercised. It must be noted, however, that the variety and intensity of these mechanisms depend on the financial standing of any given firm.[35]

Two types of creditors must be considered: lending institutions and bond creditors. Lending institutions rely primarily on financial maintenance contracts as a tool to shift corporate control towards them.[36] These covenants allow lending institutions to accelerate the entire loan if a financial metric falls below the agreed threshold. However, these institutional lenders rarely exercise their acceleration prerogatives; instead, they renegotiate with borrowers, and through that process, impose limitations and direct corporate actions.[37]

The abovementioned methodology is unavailable for bond holders. Generally, bond holders are largely impassive and are not incentivized to engage in active monitoring and renegotiations of the terms of the bond indenture.[38] Instead, bond holders rely on fine tuning the *ex ante* restrictions in the bond indenture as a method of shifting control towards them and as a hedge against any action partially favoring equity holders.[39]

The time when control shifts to the creditors is significant. Common wisdom dictates that creditor control mechanisms are triggered when corporations have defaulted or when a state of bankruptcy is on the horizon. Typically, this arises when firms have failed to pay loan installments. In cases of bankruptcy, creditors have more incentive to move for the liquidation of the firm instead of maintaining it as a going concern.[40] However, recent practice in corporate finance leans towards the imposition of covenants in debt contracts to serve as a monitoring tool for creditors of borrowers' performance. These convenants impose metrics well outside bankruptcy status; violations of these metrics give rise to "technical default" permitting

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[35] Peter Feldhütter, Edith Hotchkiss & Oguzhan Karakas, *The Value of Creditor Control in Corporate Bonds*, 121 J. FIN. ECON. 1 (2015).

[36] Doughlas Baird & Todd Henderson, *Other People's Money*, 60 STAN. L. REV 1309 (2008).

[37] Nini, Smith & Sufi, *supra* note 30.

[38] Simon Kwan & Willard Carleton, *Financial Contracting and the Choice between Private Placement and Publicly Offered Bonds*, 42 J. MONEY, CREDIT & BANKING 907 (2010).

[39] Adam Badawi, *Debt Contract Terms and Creditor Control*, UC Berkeley Public Law Research Paper (2017), *available at* https://ssrn.com/abstract=3066853.

[40] Oliver Hart & John Moore, *Incomplete Contracts and Renegotiation*, 56 ECONOMETRICA 755 (1998).

lenders to impose higher interest rates, accelerate the loan, and reduce the availability of credit, ultimately resulting in the imposition of fiscal tightening measures that affect managerial discretion in how the corporation should be run.[41] Likewise, increased control rights brought about by these convenants serve as a hedge against "liquidation bias" in times of extremely negative firm performance.

The foregoing readily demonstrates that control shifts to creditors through the use of covenants employed in direct loan contracts or as a component of indentures. There are two main categories of debt covenants: *first*, value preservation covenants, and *second*, control rights covenants.[42]

The first category is premised on balancing the conflicting interests between equity claimants and creditors, as the latter get none of the "upside benefits" of strong corporate performance but suffer from "downside evolutions."[43] Under this category of covenants, lenders impose various stipulations restricting managerial discretion regarding investment and business expansion policy, finance policy, dividend payouts, working capital requirements, resolutions of mergers and acquisitions, and other key managerial discretionary matters.[44]

The second category is aimed at the allocation of control rights between different stakeholders in a firm.[45] Covenants that define and allocate control rights stipulate "trigger events" that facilitate the shift of corporate control towards creditors thereby capacitating them to intervene in the decision making of the firm. Often, these "trigger events" relate to firm performance metrics. These metrics are set tightly, typically at levels close to those present at the time the loan agreement was entered into; consequently, the convenants can be triggered by even the slightest signal of financial distress.[46]

Covenants, therefore, have the potential of vesting *de facto* control over corporate affairs in foreign lenders while ostensibly maintaining *de jure*

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[41] Michael Roberts & Amir Sufi, *Control Rights and Capital Structure: An Empirical Investigation*, 64 J. FIN. 1657 (2009).

[42] JEAN TIROLE, THE THEORY OF CORPORATE FINANCE 51 (2006).

[43] *Id.*

[44] Michael Jensen & William Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Capital Structure*, 3 J. FIN. ECON. 305 (1976).

[45] Philippe Aghion & Patrick Bolton, *An Incomplete Contracts Approach to Financial Contracting*, 59 REV. ECON. STUD. 494 (1992).

[46] Hans Christensen & Valeri Nikolaev, *Capital versus Performance Covenants in Debt Contracts*, 50 J. ACCOUNTING RES. 75 (2012).

control with Filipino equity claimants. This could create a disonance between control in law and control in fact. To distinguish the two concepts, control in law is a quantitative standard—typically expressed under statutes, it is determined by objective factors such as percentage ownership of voting stocks.[47] On the other hand, control in fact is a qualitative concept which requires an inquiry into all attendant circumstances.[48]

II. ANALYSIS OF CREDITOR CONTROL MECHANISMS

A. Limitations of the *Gamboa* Control Test and the Grandfather Rule

Traditional wisdom in various jurisdictions treats corporate control as a numeric concept, i.e. a stockholders' bloc that possesses more than 50% of the total capital stock necessarily exercises control over corporate affairs.[49] Similarly, the *Gamboa* Decision[50] and the Grandfather Rule[51] express control as the exercise of formal voting rights;[52] thus, insofar as X *per centum* of the voting rights belong to Filipinos, coupled with beneficial ownership of X *per centum* of the outstanding capital stock, control is presumed to vest in Filipino nationals.[53] This proceeds from the premise that corporate control and management is exclusively exercised by the Board of Directors.[54] It must be noted that the Philippine concept of control rejects the notion that corporate officers can exercise it inasmuch as such officers are deemed mere agents of the Board of Directors.[55] Invariably, the Philippine concept of corporate control limits itself to a numerical threshold of voting rights.

The Philippine concept of control is narrowly defined. In stark contrast, modern day corporate governance scholars have defined *control* as the ability to choose the majority that would constitute the Board of

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[47] Jack Bernstein, *Corporate Control: An Evolving Concept*, 43 CAN. TAX J. 1412 (1995).

[48] *Id.* at 1437. *See* Office of the Superintendent of Financial Institutions Canada Advisory 2007-02 (2007).

[49] Sophia Dai & Christian Helfrich, *The Structure of Corporate Ownership and Control*, Comparative Corporate Governance and Financial Regulation, Paper 9 (2016) *available at* http://scholarship.law.upenn.edu/fisch_2016/9.

[50] 652 SCRA 690.

[51] *See Narra Nickel*, 748 SCRA 455.

[52] *Gamboa Decision*, 652 SCRA at 726.

[53] *Narra Nickel*, 748 SCRA at 478.

[54] *Id.*

[55] III RECORD CONST. COMM'N 650-51 (Aug. 23, 1986).

Directors,[56] including the power to direct managerial action,[57] and to make decisions on behalf of the firm[58] "in any manner whatever."[59] David Bayne explains that *control* is: *first*, a notion of relation, governed by contract or law; *second*, a notion of custody or responsibility in the efficient use of resources; and *third*, a notion of finality or in whose hands the final actions or decisions are determined.[60] Yin Zhaoliang defines *control* as "the possession of the power of decisive influence on a company's operational management or general and specific policies, including the power to determine its financial and operational management activities and even cause the company to become the means of achieving a specific aim."[61] The United States Federal Securities Act[62] states that control is "the power to exercise a controlling influence over a company's operational management or general and specific policies."[63] This is in line with the definition provided by the International Financial Reporting Standards 10,[64] which defines control as the investor's "ability to affect [variable] returns through its power over the investee," and for which power pertains to the investor's "current ability to direct the *relevant activities*, [*i.e.*] the activities that significantly affect the investee's returns."[65]

From the foregoing, the modern appreciation of the concept of control is not limited to a quantitative threshold of voting rights but is, rather, the exercise and possession of the power to influence corporate decision-making by whatever means available. The concept of control, therefore, requires an appreciation of the attendant circumstances to

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[56] *See* ADOLF BERLE & GARDINER MEANS, THE MODERN CORPORATION & PRIVATE PROPERTY (1991).

[57] John Campbell, *The Palgrave Dictionary of Money and Finance*, 32 J. ECON. LITERATURE 667 (1994).

[58] Rafael La Porta, Florencio Lopez De Silanes & Andrei Shleifer, *Corporate Ownership Around the World*, 54 J. FIN. 471 (1999).

[59] Office of the Superintendent of Financial Institutions Canada Advisory 2007-02 (2007).

[60] David Bayne, *A Philosophy of Corporate Control*, 112 U. PA. L. REV. 22 (1963).

[61] Organisation for Economic Co-operation and Development, *The Theory of the Market for Corporate Control and the Current State of the Market for Corporate Control in China*, OECD WEBSITE, *available at* http://www.oecd.org/corporate/ca/corporategovernanceofstate-ownedenterprises/31601011.pdf, *citing* Yin Zhaoliang, *A Study of Some Legal Problems of Corporate Control* (2001).

[62] 48 Stat. 74 (1933).

[63] Organisation for Economic Co-operation and Development, *supra* note 61.

[64] International Financial Reporting Standards 10: Consolidated Financial Statements, ¶ 5, *available at* http://eifrs.ifrs.org/eifrs/bnstandards/en/IFRS10.pdf.

[65] *Id* at ¶ 10.

determine in whose hands the financial and operating policies of a corporation is determined.[66]

B. Limitations of the Philippine Anti-Dummy Law

The Philippine Anti-Dummy Law[67] prohibits any arrangement which permits foreigners to take advantage and use a Filipino's citizenship as a way to control corporations engaged in wholly or partially nationalized economic activities in contravention of constitutionally or statutorily imposed nationality restrictions.[68] The law prohibits two categories of action: *first,* the simulation of capital stock,[69] and *second,* foreign participation in the management of a corporation engaged in nationalized or partially nationalized economic activities.[70]

The *first* contemplates the existence of an illegal partnership, agency, or trust arrangement between a Filipino and a foreigner *in relation to corporate shares.*[71] Stated differently, there is simulation of capital stock where, ostentibly, the documentation evinces compliance with the nationality requirements but in truth, the percentage of local ownership is below the required threshold. Thus, an inquiry must be made "into the citizenship of the individual stockholders, i.e. natural persons, of that investor-corporation in order to determine if the Constitutional and statutory restrictions are complied with."[72] A violation of Section 2 of the Anti-Dummy Law requires compliance with both the Control Test and the Grandfather Rule;[73] thus, with respect to the question of control, it suffers from the same limitations discussed in Section A of Part II.

With respect to the *second,* Section 2-A of the Anti-Dummy Law, as a general rule, proscribes foreign nationals from participating in the management, operation, administration, or control of any corporation engaged in nationalized or partially nationalized economic activities. Exceptionally, foreigners' intervention as technical personnel may be

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[66] *Id* at ¶ 8.

[67] Com. Act No. 108 (1936). Anti-Dummy Act. *See* J.G. Summit Holdings, Inc. vs. Ct. of Appeals, G.R. No. 124293, 450 SCRA 169, Jan. 31, 2005.

[68] § 1.

[69] § 2.

[70] § 2-A.

[71] § 2.

[72] Op. of the SEC Office of Gen. Couns. 10-31 (December 9, 2010).

[73] *Narra Nickel,* 748 SCRA 455.

permitted provided it is authorized by the Secretary of Justice[74] or specifically provided for by law.[75]

It must be noted that the prohibition on participation and intervention of foreign nationals under Section 2-A has been narrowly defined. In *King v. Hernaez*,[76] the proscription limits itself to the election, appointment, or employment of foreign nationals in "any position pertaining to management, operation, administration, and control," as well as "in a minor or clerical or non-control position."[77] This is echoed by an Opinion of the Secretary of Justice,[78] stating that in the case of corporations engaged in nationalized or partially nationalized economic activities, foreigners are banned from being appointed to managerial positions such as president, vice-president, treasurer, auditor, etc.; however, such aliens can be elected as directors in proportion to the allowable participation as may be provided by law.[79] Thus, under Section 2-A, the proscription in the control and intervention of foreign nationals in the management and policy-making of a corporation engaged wholly or partially in nationalized economic activities is limited to *direct participation*, i.e., employment in whatever capacity unless otherwise specifically authorized by law.

Evidently, the Philippine Anti-Dummy Law does not concern itself with the possibility of creditor control mechanisms that permit foreign lenders to *indirectly* participate, intervene, and control the policy and decision making processes of a domestic corporation engaged in nationalized and partially nationalized economic activities, notwithstanding the lack of voting control or direct employment in such corporation.

C. Discussion and Comments on Various Creditor Control Mechanisms

The following are devices that create *de facto* control in a corporation, without any voting rights or without majority of voting rights held by the foreign stockholder: (1) loan covenants, (2) contractual veto rights, (3) callable loans, and (4) leveraged shareholding. However, the enumeration is not exclusive.

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[74] Com. Act No. 108 (1936), § 2-A.

[75] *See* Rep. Act No. 387 (1949), art. 26. Petroleum Act of 1949; Rep. Act. No. 5186 (1967), § 7(g). Investment Incentives Act; *and* Pres. Dec. No. 463 (1974), § 60. Mineral Resources Development Decree of 1974.

[76] G.R. No. L-14859, 4 SCRA 792, Mar. 31, 1962.

[77] *Id.* at 802.

[78] Op. of the Sec. of Justice 37 (1976).

[79] Op. of the SEC Office of Gen. Couns. 12-01 (Jan. 31, 2012).

1. Loan Covenants

Loan covenants allocate corporate control between equity claimants and creditors insofar as they define instances whereby control shifts from the former to the latter.[80] Generally, there are three types of financial covenants: *first,* affirmative covenants; *second,* negative covenants; and *third,* financial covenants.

The *first* requires the borrower to do something,[81] e.g. the timely filing of financial statements, payment of taxes, compliance with SEC reportorial requirements, etc.; while the *second* enjoins the borrower from doing something,[82] e.g. the sale of substantial number of assets, payment of dividends, expenditures for expansion, etc. On the other hand, the *third,* requires borrowers *not* to breach the threshold of a *financial metric* determined by the lender at the time the loan was entered into.[83] Stated differently, it requires the debtor-institution to maintain a certain level of operating performance and, consequently, financial health.

Foreign banks and lending institutions directly contracting with Filipino borrowers use financial covenants to allow them to impose higher interest rates, accelerate the entire amount of the loan, and reduce the availability of credit if a financial metric breaches a specified threshold in the loan agreement.[84] The degree of restrictiveness of the covenants imposed is a function of the degree of credit risk assumed by the lender.[85] In other words, the greater the amount of the loan, the greater the credit risk assumed by the lender, then the greater the restrictiveness of the covenants imposed; consequently, the greater the potential for creditor control.

It must be noted, however, that foreign banks and lending institutions, in case of technical default,[86] rarely exercise their default

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[80] *See* Mai Daher, *Creditor Control Rights, Capital Structure and Legal Enforcement*, 44 J. CORP. FIN. 308 (2017), *available at* https://ssrn.com/abstract=2594186.

[81] *Id.*

[82] *Id.*

[83] *See* Nini, Smith & Sufi, *supra* note 10.

[84] *See* Badawi, *supra* note 39.

[85] Jing Wang, *Debt Covenant Design and Creditor Control Rights: Evidence from Covenant Restrictiveness and Loan Outcomes* (2013), *available at* https://fisher.osu.edu/sites/default/files/debt_covenant_design_and_creditor_control_rights_evidence_from_covenant_restrictiveness_and_loan_outcomes.pdf.

[86] Defined as a short fall in a loan agreement which does not arise from a failure to make payments. *See Definition of Technical Default,* FINANCIAL TIMES LEXICON WEBSITE, *available at* http://lexicon.ft.com/Term?term=technical-default (last accessed Dec. 29, 2018).

prerogatives under the loan agreement;[87] instead, they renegotiate with the debtors and, through that process, impose undertakings and other retrictions on the Filipino borrower-corporation's policy.[88] Notably, the foreign lenders, at the point of technical default, are at an advantageous bargaining position, since the risk of the lenders declaring all debts outstanding increases the risk of bankruptcy.[89]

> Illustration: A domestic corporation engaged in the telecommunications business has insufficient capital to sustain its operating costs. Consequently, it receives additional capital through the execution of a Loan Agreement with a foreign bank. The loan provides a covenant that requires the borrower to maintain a minimum net worth. Assume that, at the time of loan origination, the firm's net worth stands at PHP 10 billion; assume further that the loan amounted to PHP 5 billion and the covenant stipulation requires that the firm's net worth must not fall below PHP 9.5 billion.
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> Because of the chief technology officer's ("CTO") excessive risk-taking (in the acquisition of various start-ups), the firm's net worth fell to PHP 9 billion. The foreign bank threatened to declare the loan outstanding unless the following terms are met: (1) the CTO is replaced; (2) dividend payments be suspended until 50% of the restructured loan is repaid; (3) a moratorium on the acquisition of technology start-ups until the corporation's net worth increases to PHP 12 billion; and (4) the employment of technical consultants chosen by the creditor bank. Fearing bankruptcy, the domestic corporation accedes.

The foregoing demonstrates the following: *first*, the covenant could be set tightly, close to the net worth of the firm at the time of loan origination such that the financial covenant is triggered by even moderate financial distress; *second*, if a domestic corporation is heavily leveraged in favor of the foreign bank, it gives the latter a strong bargaining position as against the former; and *third*, after technical default, the foreign creditor can impose strict restrictions on the firm's operating and investing policy, including the choice of officers. Immediately apparent from the foregoing is that the Filipino borrower-corporation, because of a confluence of factors, can be compelled to make substantial concessions to the foreign creditor

[87] Badawi, *supra* note 39.

[88] Nini, Smith & Sufi, *supra* note 30.

[89] Charles Whitehead, *Creditors and Debt Governance*, Cornell Law Faculty Working Papers 86 (2011), *available at* https://scholarship.law.cornell.edu/cgi/viewcontent.cgi?article=1089&context=clsops_papers.

during covenant renegotiations. Post-renegotiation, the foreign lender bank can impose new restrictive covenants that severely limit managerial discretion. Evidently, therefore, the foreign bank, in a post-renegotiation scenario, can gain possession of control over the financial, managerial, and operational direction of the domestic corporation.

Generally, the calculus employed by banks and lending institutions is inapplicable with respect to bond creditors. Typically, bond creditors do not have the sophistication of banks and lending institutions in monitoring covenant violations owing to their diffuse and largely passive nature.[90] To enforce their rights, bond creditors group themselves for the purpose of "activism" or the enforcement of provisions in the bond indenture.[91] The usual strategy employed is for bond creditors to go to court challenging the interpretation of certain provisions in the bond indenture.[92] This is known as an interpretative dispute.

> Illustration: Corporation A, a domestic corporation engaged in the cable television broadcasting, announced a merger agreement with a Corporation B, a domestic media and entertainment conglomerate. Assume that according to the agreement, Corporation 1, a subsidiary of Corporation B, was to merge with Corporation 2, a subsidiary of Corporation A, with Corporation 1 shareholders receiving one share of Corporation A for each share of Corporation 1. Prior to the merger, Corporation B distributed its stock of Corporation 1 to its shareholders, in order that the former's shareholders will receive Corporation B's stocks in the merger. Assume that Corporation B's controlling shareholder, Corporation C, had signed a Support Agreement requiring it to oppose any alternative transaction. Assume further that a group of foreign bond creditors are in possession of a Note trading at a substantial discount to their principal amount. The indenture on the Note provides that the consent of two-thirds (2/3) of all Note holders is required in cases of "Fundamental Changes" unless the issuer purchases the Notes at par. The group of bond creditors sends a notice of default asseverating that the merger amounts to a fundamental change, and threatens to withhold consent unless and until the Note is repurchased by Corporation A at par value. Corporation A argues that no fundamental change arose, as it did not itself merge.

[90] Badawi, *supra* note 39.

[91] Marcel Kahan & Edward Rock, *Hedge Fund Activism in the Enforcement of Bondholder Rights*, 103 NW. U. L. REV. 281 (2009).

[92] *Id.*

In this case, enforcement by bond creditors via interpretative dispute of the terms of the indenture can be construed as an implied restriction on the power of the board of directors and the corporate officers to engage in fundamental business decisions albeit in the absence of voting rights. Thus, the foreign bond creditors can exercise a substantial amount of control in the policy direction of the domestic Corporation A.

2. Contractual Veto Rights

Contractual veto rights typically pertain to minority shareholders to provide them a measure of control over corporate decisions that would adversely affect their equity interest.[93] However, recent practice in corporate finance saw a marked increase in the use of contractual provisions granting veto prerogatives to creditors.[94] Notably, these veto rights may signal foreign creditor *de facto* control of the corporation depending on their scope and degree. The veto rights achieve increased potency if the consent of the foreign creditor is needed in every important business decision.

> Illustration: Corporation A, a local conglomerate engaged in nationalized and partially nationalized economic activities, announced the sale of its commercial bank chain to Corporation B. Corporation A has previously issued Senior Subordinated Notes. Corporation B assumes 80% of the total value of the Senior Subordinated Notes issued by Corporation A, thereby releasing the latter. Assume that the Indenture of the Notes provides the following: *first,* that Corporation A may transfer "all or substantially all" of its assets to another entity if the latter assumes all the obligations in the Indenture; and *second,* the Note Holders may veto any transaction involving less that the sale of "substantially all" the assets. The Note Holders issue a notice of default, and veto the transaction asseverating that the sale does not involve "all or substantially all" of Corporation A's assets.

The above illustration demonstrates that veto rights can be interpreted as: *first,* an implied grant of voting rights to foreign creditors effectively emulating majority or voting control notwithstanding the lack of voting rights, and *second,* an implied dilution of Filipino shareholder's voting control in key business decisions, regardless of the fact that the foreign creditors exercise no voting right.

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[93] F. Hodge O' Neal, *Arrangements which Protect Minority Shareholders against Squeeze-Outs*, 45 MINN. L. REV. 537 (1960).

[94] Michelle Harner & Jamie Manrincic Griffin, *Behind Closed Doors: The Influence of Creditors in Business Reorganizations*, 34 SEATTLE U.L. REV. 1155 (2011).

3. Callable Loans

A callable loan is a loan agreement with a call option. A call option is a contractual arrangement which gives an investor the right, but not the obligation, to purchase an equity instrument, fixed income instrument, foreign exchange, and other commodities at a specified price on or before a specified settlement or expiration date.[95] In the context of a loan agreement, a call option gives the lender a right, but not the obligation, to demand full payment of the loan if the borrower breaches any or some of the covenants in the loan agreement.[96] Some call provisions do not necessitate a breach by the borrower before the lender can exercise a call—the lender may simply find that the borrower is in a precarious financial position.

> Illustration: Corporation A is a domestic corporation engaged in the real estate business. Filipino nationals hold a majority of the position in the board of directors. The corporation is in a precarious financial condition and is unable to secure capital through local sources to finance its projects. As an alternative, it executes a Callable Loan Agreement with a foreign creditor. Assume that the loan provides a covenant which enjoins Corporation A to restrict its development activities to commercial projects in the Metropolitan Manila area. Because of the gentrification in a certain district in Manila, the board resolves to develop one of its lands for residential purposes. The foreign creditor sends a notice of default invoking the covenant; subsequently, to dissuade the foreign creditor from exercising its call option, the board abandons the initial plans for the project.

In this case, it is readily observable that the net effect of this contractual set-up is to motivate the Filipino stockholders to act in the interest of the foreign provider of capital to dissuade the latter from exercising its call option.

Additionally, it must noted that a callable loan becomes even more potent if it is embedded with contractual veto rights in favor of the foreign lender as discussed in Section C-2, Part II of this Note. The grant of veto prerogatives to the foreign lender allows it to interfere with major business

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[95] *Definition of Call Option,* INVESTOPEDIA WEBSITE, *available at* https://www.investopedia.com/terms/c/calloption.asp (last accessed Dec. 28, 2018). *See* Allaire Corp. v. Okumus, 433 F.3d 248 (2d Cir. 2006). *See also* Glass v. Commissioner of Internal Revenue, 87 T.C. 1087 (T.C. 1986).

[96] Harner & Griffin, *supra* note 94.

decisions. Hence, under the foregoing arrangement, the lender exercises control over the borrower.

It must be noted that, under a callable loan, the foreign lender's control increases if the following factors are present: (1) the borrower is illiquid and has no viable alternative source of funding, (2) the veto prerogatives affect corporate action over sources of revenue, and (3) the lender is capable of exercising the call option without breach of the loan agreement or any of its covenants.

4. Leveraged Shareholding

There is leveraged shareholding when a foreign stockholder holds equity interest in the corporation and, at the same time, is a major source of debt financing. It allows for an indirect deviation from the one-share one-vote principle:[97] what the foreign stockholder cannot achieve through an exercising of formal voting rights, he may attempt to achieve through loan covenants or other similar arrangements, e.g. dual class shares, stock pyramids, cross-ownership, etc.[98] Thus, corporate governance scholars have often referred to this type of contractual arrangement as a "control-enhancing mechanism."[99] This differs from the use of callable loans, where the power to call the loan motivates the stockholders to act in the interest of the foreign provider of credit. Under leveraged stockholding, the foreigner is both a stockholder and a creditor.

An illustration for this is provided in the Introduction of this Note.

III. PROPOSAL FOR AN EXPANDED REGULATORY REGIME

Before proceeding to a discussion of an expanded regulatory framework, a word must be said about the historical context of the Constitution's evident bias toward economic nationalism. The state of the Philippine economy following the conclusion of the Second World War was succinctly described by President Manuel Roxas in his inaugural address on

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[97] FRANK EASTERBROOK & DANIEL FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 67 (1991).

[98] Yu-Hsin Lin, *Controlling Controlling-Minority Shareholders: Corporate Governance and Leveraged Corporate Control*, 453 COLUM. BUS. L. REV. 453, 461 (2017).

[99] *Id.*

May 28, 1946: "[t]here is hunger among us."[100] The Americans offered financial assistance to the Philippines in order to facilitate its rehabilitation. An amount of USD 620 million was offered, provided that the Philippines accede to the provisions of the Bell Trade Act,[101] which provided for free trade between the two states and parity rights for Americans in the exploitation of natural resources of the Philippines; otherwise, no amount in excess of USD 500 would be released to the fledgling Philippine Republic.[102] Owing to the exigencies of the time, President Roxas was compelled to accede to the agreement. In the following decade, Philippine political leaders achieved economic reprieve through the abandonment of the Bell Trade Act in favor of the Laurel-Langley Agreement, which "accelerated the imposition of Philippine duties on American products and inversely slowed down the imposition of U.S. duties on Philippine products," [103] but expanded the scope of the parity rights to include all areas of economic activity.[104]

The trend of economic nationalism initiated by the Laurel-Langley Agreement was stymied in 1962 when President Diosdado Macapagal abandoned economic patriotism as a policy in exchange for a USD 300 million loan from the International Monetary Fund. What followed was an onslaught of imported goods which undermined the growth of the local manufacturing industries and caused an exodus of foreign capital and a repatriation of profits that led to the unrelenting decline of the country's dollar reserves.[105] This tenor of economic de-control continued under the regime of President Ferdinand Marcos who believed that prosperity is "inseparable from the philosophy of free enterprise."[106] The Macapagal and Marcos administrations' dismantling of nationalist economic controls over foreign trade and the preference for foreign investment facilitated the decline of the Philippine economy into what former President Jose P. Laurel

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[100] Manuel Roxas, *Inaugural Address of President Roxas, May 28, 1946*, OFFICIAL GAZETTE WEBSITE, *available at* http://www.officialgazette.gov.ph/1946/05/28/inaugural-address-of-president-roxas-may-28-1946/ (last accessed Dec. 28, 2018).

[101] 60 Stat. 141 (1946). Philippine Trade Relations Act.

[102] Jose Victor Jimenez, The Economic Nationalism of Jose P. Laurel, De La Salle University Research Congress (Mar. 2-4, 2015), *available at* http://xsite.dlsu.edu.ph/conferences/dlsu_research_congress/2015/proceedings/TPHS/016TPH_Jimenez_JVD.pdf.

[103] *Id.*

[104] *Id.*

[105] Jose Victor Jimenez, Economic Nationalism: A Healing Salve for Philippine Economic Woes, De La Salle University Research Congress (Mar. 7-6, 2016), *available at* https://xsite.dlsu.edu.ph/conferences/dlsu-research-congress-proceedings/2016/TPHS/TPHS-09.pdf.

[106] *Id.*

classified as a "colonial-type economy" or one which "relies mainly upon the production of raw materials for export with the unfortunate consequence that not enough foodstuffs for home consumption needs are raised, and some have to be imported annually."[107]

The exploitation of the Philippine economy by foreign nationals, including the use of natural resources and domination of strategic economic activities, was the motivation behind the maintenance of nationality clauses in the 1987 Constitution. As observed by the *ponencia* of Justice Antonio Carpio in the *Gamboa Resolution*, throughout the country's economic history, there has always been bitter opposition to foreign intervention and domination of the national economy.[108]

It is with this historical perspective in mind that this proposal for an expanded regulatory framework is made. To be sure, not all creditor-control mechanisms, in and of themselves, violate the constitutional policy of reserving effective control to Filipinos citizens in key economic activities. Lenders must be allowed to impose some restrictions on managerial discretion in order to ensure the credit quality of the borrower-firm[109] and to curb actions that would harm their interests.[110] Further, it must be noted that resort to loans and credit accommodations by domestic corporations is in keeping with standard business practice to ensure that the company is sufficiently capitalized.[111] Thus, in proposing an expanded regulatory regime to address the phenomenon of creditor control mechanisms in corporations engaged in nationalized and partially nationalized activities, careful balance must be reached between the right of creditors to protect their interest[112] and the borrower's business judgment,[113] and the overriding policy of the Constitution to grant effective control of selected economic activities to Filipinos.[114] Therefore, the question that must be addressed is: what is the threshold before the level of control exercised by creditors becomes constitutionally unacceptable?

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[107] JOSE P. LAUREL, BREAD AND FREEDOM 92 (1953).

[108] 682 SCRA 397.

[109] Kee-Hong Bae & Vidhan Goyal, *Creditor Control Rights, Enforcement, & Bank Loans*, 64 J. FIN. 823 (2009), *available at* https://ssrn.com/abstract=423820.

[110] Badawi, *supra* note 39.

[111] TIROLE, *supra* note 42, at 80.

[112] Chester Rohrlich, *Creditor Control of Corporations Operating Receiverships Corporate Organization,* 19 CORNELL L. REV. 35, 40 (1933).

[113] Balinghasay v. Castillo, G.R. No. 185664, 755 SCRA 276, Apr. 8, 2015.

[114] JOAQUIN BERNAS, THE CONSTITUTION OF THE REPUBLIC OF THE PHILIPPINES 452 (2009).

To address this question, the regulatory framework must adopt a test similar to the Canadian practice which determines control not only as a quantitative concept but also as a qualitative concept. Under Canadian law, an individual or entity is deemed to be in control of a corporation if he or she "has any direct or indirect influence that, if exercised, would result in control in fact of a corporation."[115] Under this definition, potential influence, even if not exercised, is sufficient to constitute *de facto* control. *De facto* control, therefore, embraces all means and manner, except *de jure* control, by which a person may govern the policy of a corporation.

Canadian law considers the following as indicators of *de facto* control:[116]

1. Where a person or entity has the power to materially shape the operations of a corporation. This is indicated by the person or entity's ability: (a) to appoint, block the appointment of, remove or replace the officer's of the firm; (b) to make, veto, or constrain strategic decisions regarding the business of the corporation, including its capital expenditure plan, finance policy, dividend policy, and day-to-day operations; and/or (c) to exert economic and financial influence over corporate officers.[117]

2. Where a person or entity can exert significant economic pressure that could affect a corporation's future or viability. This can be deduced from: (a) the size of financing given to the corporation,[118] including its terms and conditions; (b) the potential impact of the withdrawal of such financial support; and/or (c) the nature and extent of business relations and/or business arrangements.[119]

3. Where the person or entity can influence, in whatever way, the Board of Directors.[120]

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[115] Bernstein, *supra* note 47, at 1427.

[116] This list is non-cumulative and non-exhaustive.

[117] Office of the Superintendent of Financial Institutions Canada Advisory 2007-02 (2007).

[118] Bernstein, *supra* note 47, at 1427.

[119] Office of the Superintendent of Financial Institutions Canada Advisory 2007-02 (2007).

[120] *Id.*

Two things can be observed from the above disquisition: *first*, the Canadian indicators of *de facto* control resemble the badges of "dummy status" provided by the DOJ;[121] and *second*, these indicators of control pertain to the influence of a person or entity, not only on the day-to-day operations and management of a firm, but also over fundamental matters similar to those referred to in the Corporation Code.[122]

To reiterate, the Canadian practice defines control as not only being limited to the possession of majority voting rights, but includes any and all facts and circumstances showing the practical ability to influence corporate policy. This definition of control must be adopted in our jurisdiction if only to breathe life into the constitutional policy of maintaining effective control by Filipinos of key areas of the economy. Thus, if a foreign creditor, through a combination of covenants, veto rights, and other contractual arrangements, is able to influence the daily operations of a firm, submitted matters, *and* fundamental matters, then it should be deemed to be constitutionally infirm. The final word of the *ponencia* of Justice Carpio in the *Gamboa Resolution* is significant:

> Filipinos have only to remind themselves of how this country was exploited under the Parity Amendment, which gave Americans the same rights as Filipinos in the exploitation of natural resources, and in the ownership and control of public utilities, in the Philippines.[123]

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[121] Op. of the Sec. of Justice 165 (Nov. 2, 1984).

[122] *See* Batas Blg. 68 (1980), § 6, ¶ 6. The Corporation Code of the Philippines.

[123] *Gamboa Resolution*, 682 SCRA at 468.