Republic of the Philippines
Department of Finance
Securities and Exchange Commission
SEC Building, EDSA, Greenhills, Mandaluyong City
Office of the General Counsel

02 February 2012

SEC-OGC Opinion No. 12-02
Re: Allowable Foreign Participation in a Corporation and in the Board of Directors; Place of Incorporation Test; Control Test and Grandfather Rule

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Corporate Secretary
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115 Aguirre St., Legaspi Village,
Makati City

Mesdames:

This refers to your letter dated 06 July 2011 requesting for confirmation on whether the total percentage of foreign equity in each of CMPI Holdings, Inc. ("CMPI Holdings") and CMPI Land, Inc. ("CMPI Land") is 40%, which allows foreigners to have a maximum of four (4) out of nine (9) seats in each of the Board of Directors.

As disclosed in your letter, CMPI Holdings was in the process of filing with this Commission its application for the decrease of its authorized capital stock. After filing its request for clearance with the Law and Regulation Division, CMPI Holdings was found to have exceeded the allowed number of board seats for foreign nationals, that is, there should only be two (2) foreigners in its Board of Directors.

Your letter illustrates that the equity participation and the composition of the Board of Directors in CMPI Holdings and CMPI Land are as follows:

CMPI Holdings		CMPI Land	
Stockholders	Equity Participation	Stockholders	Equity Participation
Ayala Land, Inc. ("ALI") (Filipino)	60%	CMPI Holdings, Inc. (Filipino)	60%
Cementhai Roof Holdings (Phils.), Incorporated ("Cementhai") (Thai)	20%	Cementhai Roof Holdings (Phils.), Incorporated (Thai)	20%
Lafarge International Holdings Limited ("Lafarge") (British)	20%	Lafarge International Holdings Limited (British)	20%
Total	100%	Total	100%

CMPI Holdings		CMPI Land	
Composition of the Board	Nationality	Composition of the Board	Nationality
1. Jaime E. Ysmael	Filipino	1. Jaime E. Ysmael	Filipino
2. Jose Emmanuel H. Jalandoni	Filipino	2. Jose Emmanuel H. Jalandoni	Filipino
3. Ronald F. Cuadro	Filipino	3. Ronald F. Cuadro	Filipino
4. Surasak Kraiwitchaicharoen	Thai	4. Surasak Kraiwitchaicharoen	Thai
5. Emilie B. Maramag	Filipino	5. Emilie B. Maramag	Filipino
6. Arnel H. Nacor	Filipino	6. Arnel H. Nacor	Filipino
7. Georg Harrasser	Italian	7. Georg Harrasser	Italian
8. Walter Benz	German	8. Walter Benz	German
9. Rosario Z. Nava	Filipino	9. Rosario Z. Nava	Filipino

Your letter further states that Cementhai, one of CMPI Holdings and CMPI Land's stockholders, is a domestic corporation, which is 100% owned by SCG Building Materials Co., Ltd, a Thai company.

Given the foregoing facts, you seek confirmation from this Office on whether[1] –

a. Cementhai is a Thai company;

b. The total percentage of foreign equity in each of CMPI Holdings and CMPI Land is 40%, which is comprised by Cementhai's and Lafarge's ownership of the companies; and

c. The total percentage of foreign equity in each of CMPI Holdings and CMPI Land allows foreigners to have a maximum of four (4) out of nine (9) seats in each of the Board of Directors.

Relevant to your first query is the manner of determining the nationality of a corporation. It is basic in corporate law that the nationality of a corporation serves as a legal basis for subjecting an enterprise or its activities to the laws, the economic and fiscal powers, and the various social and financial policies of the state to which it is supposed to belong.[2] It must be emphasized that the primary test under Philippine jurisdiction in determining the nationality of a corporation is the incorporation test, wherein a corporation is considered a national of the country under whose laws it was incorporated, *viz* –

> **Under Philippine jurisdiction, the primary test is always the Place of Incorporation Test since we adhere to the doctrine that a corporation is a creature of the State whose laws it has been created.** A

[1] Letter dated 06 July 2011, p. 3.
[2] SEC-OGC Opinion No. 22-07 dated 07 December 2007, addressed to Atty. Teodulo G. San Juan, Jr.

corporation organized under the laws of a foreign country, irrespective of the nationality of the persons who control it is necessarily a foreign corporation. **The control test and the principal place of business test (siege social), are merely adjunct tests, when the place of incorporation test indicates that the subject corporation is organized under Philippine laws.** (Villanueva, Philippine Corporate Law, p. 58)[3] (Emphasis supplied).

Thus, Cementhai, having been incorporated under the laws of the Philippines on 27 November 1996 with SEC Registration No. A199609823, is a Filipino corporation pursuant to the place of incorporation test.

However, while the incorporation test serves as the primary test under Philippine jurisdiction, other tests such as the Control Test and the Grandfather Rule must also be applied in determining compliance with the provisions of the Constitution and of other laws on nationality requirements.[4] The Commission, in a plethora of opinions, utilized the Control Test or the Grandfather Rule in determining the eligibility of a corporation, which has foreign equity participation in its ownership structure, to engage in nationalized or partly nationalized activities, *viz* –

> **Shares belonging to corporations or partnerships at least 60% of the capital of which is owned by Filipino citizens shall be considered as of Philippine nationality, but if the percentage of Filipino ownership in the corporation or partnership is less than 60%, only the number of shares corresponding to such percentage shall be counted as of Philippine nationality.** Thus, if 100,000 shares are registered in the name of a corporation or partnership at least 60% of the capital stock or capital respectively, of which belong to a Filipino citizens, all of the said shares shall be recorded as owned by Filipinos. But if less than 60%, or, say, only 50% of the capital stock or capital of the corporation or partnership, respectively belongs to Filipino citizens, only 50,000 shares shall be counted as owned by Filipinos and the other 50,000 shares shall be recorded as belonging to aliens.
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> x x x x x x x x x
>
> **Under the above-quoted SEC Rules, there are two cases in determining the nationality of the Investee Corporation. The first case is the 'liberal rule,' later coined by the SEC as the Control Test in its 30 May 1990 Opinion, and pertains to the portion in said Paragraph 7 of the 1967 SEC Rules which states, '(s)hares belonging to corporations or partnerships at least 60% of the capital of which is owned by Filipino citizens shall be considered as of Philippine nationality.'** Under the liberal Control Test, there is no need to further trace the ownership of the 60% (or more) Filipino stockholdings of the Investing Corporation since a corporation which is at least 60% Filipino-owned is considered as Filipino.

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[3] SEC-OGC Opinion No. 11-42 dated 12 October 2011, addressed to Mr. James B. Yee, citing SEC Opinion No. 04-14 dated 03 March 2004, addressed to Tan & Concepcion Law Firm.
[4] *Id.*

> **The second case is the Strict Rule or the Grandfather Rule Proper and pertains to the portion in said Paragraph 7 of the 1967 SEC Rules which states, "but if the percentage of Filipino ownership in the corporation or partnership is less than 60%, only the number of shares corresponding to such percentage shall be counted as of Philippine nationality."** Under the Strict Rule or Grandfather Rule Proper, the combined totals in the Investing Corporation and the Investee Corporation must be traced (i.e., "grandfathered") to determine the total percentage of Filipino ownership.
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> **Moreover, the ultimate Filipino ownership of the shares must first be traced to the level of the Investing Corporation and added to the shares directly owned in the Investee Corporation.** x x x
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> x x x x x x x x x
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> In other words, based on the said SEC Rule and DOJ Opinion, the **Grandfather Rule** or the second part of the SEC Rule **applies only when the 60-40 Filipino-foreign equity ownership is in doubt** (i.e. in cases where the joint venture corporation with Filipino and foreign stockholders with less than 60% Filipino stockholdings [or 59%] invests in other joint venture corporation which is either 60-40% Filipino-alien or 59% less Filipino). Stated differently, where the 60-40 Filipino-foreign equity ownership is not in doubt, the Grandfather Rule will not apply." (Emphasis supplied).[5]

Since the eligibility of Cementhai to engage in a nationalized or partly nationalized activity was not raised as an issue, we will not proceed to apply the Control Test or the Grandfather Rule, whichever is applicable, to determine Cementhai's nationality.

Moving now to your second and third queries, it is necessary to ascertain whether CMPI Holdings and CMPI Land are engaged in nationalized or partially nationalized activities and therefore, are subject to nationality restrictions imposed by the Constitution and other pertinent laws. If it is so, then CMPI Holdings and CMPI Land are covered by Section 2-A of Commonwealth Act No. 108, as amended by Presidential Decree No. 715, otherwise known as "An Act to Punish Acts of Evasion of the Laws on the Nationalization of Certain Rights, Franchises or Privileges" (The Anti Dummy Law), which states that –

> *Section 2-A. Unlawful Use, Exploitation or Enjoyment. xxx xxx xxx And provided, finally, that **the election of aliens as members of the board of directors or governing body of <u>corporations or associations engaging</u>***

[5] SEC-OGC Opinion No. 11-44 dated 27 October 2011, addressed to Atty. Wilfredo M. Penaflor; SEC-OGC Opinion No. 11-26 dated 19 April 2011, addressed to Mr. Edgardo C. De Leon citing Department of Justice (DOJ) Opinion No. 020, series of 2005, addressed to then Secretary of the Department of Finance, the Honorable Cesar Purisima; SEC-OGC Opinion No. 10-20 dated 27 May 2010, addressed to Castillo Laman Tan Pantaleon & San Jose Law Firm; SEC-OGC Opinion No. 10-08 dated 08 February 2010, addressed to Mr. Teodoro B. Quijano; SEC Opinion dated 02 January 1990, addressed to Atty. Eduardo F. Hernandez; DOJ Opinion No. 018 dated 19 January 1989.

***in partially nationalized activities* shall be allowed in proportion to their allowable participation or share in the capital of such entities.**

A perusal of CMPI Holdings' Articles of Incorporation shows that its primary purpose is that of a holding company, *viz*–

> "To acquire by purchase, exchange, assignment, gift or otherwise, and to hold, own and use for investment or otherwise, and to sell, assign, transfer, exchange, mortgage, pledge, traffic and deal in and with and otherwise to enjoy and dispose of, any bonds, debentures, promissory notes, shares of capital stock, or other securities or obligations, created, negotiated or issued by any corporation, association, or other entity, foreign or domestic, and while the owner thereof, to exercise all the rights, powers and privileges of ownership, including the right to receive, collect, and dispose of, any and all dividends, interest and income, derived therefrom, and the right to vote on any shares of the capital stock, and upon any bonds, debentures, or other securities, having voting power as owned, and to issue proxies for said purpose, but only to the extent permitted by law; to aid in any manner authorized by law, any corporation, association, partnership, individual or entity of which this corporation is a holder of any bonds, debentures, promissory notes, shares of capital stock, or other securities, or obligations and any interest therein, are held or owned by this corporation, and generally to do any lawful acts and things designed to promote, protect, preserve, improve or enhance the value of any such bonds, debentures, promissory notes, shares of capital stock, securities or obligations."

It must be pointed out that a holding company with paid-in equity capital of less than the equivalent of US$200,000.00 is partially reserved to Philippine nationals under Section 8 of Republic Act No. 7042, otherwise known as the Foreign investments Act of 1991 (FIA), as amended by Section 3 of Republic Act No. 8179 and List B of Executive Order No. 858 or the Eight Regular Foreign Investment Negative List (FINL), and therefore, is subject to forty percent (40%) limitation in foreign equity participation.[6]

In CMPI Holding's case, its 2010 GIS showed that the amount of its paid-up capital is Forty Nine Million Two Hundred Thousand Pesos (Php 49,200,000.00). With this paid-up capital, this Office is of the opinion that CMPI Holdings, being a holding company and having exceeded the required minimum paid-in equity capital equivalent of Two Hundred Thousand US Dollars (US$200,000.00) in Philippine Peso under the FIA, as amended, is not covered by the forty percent (40%) restriction on foreign equity participation found in List B of the FINL. In other words, CMPI Holdings is not engaged in a partially nationalized activity and therefore, is not subject to nationality restrictions imposed by the Constitution and other pertinent laws and is not covered by Section 2-A of the Anti-Dummy Law.

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[6] SEC-OGC Opinion No. 11-25 dated 19 April 2011, addressed to Saulog & De Leon Law Offices; SEC-OGC Opinion No. 09-30 dated 23 November 2009, addressed to Gonzales Batiller David Leabres & Reyes; SEC Opinion dated 25 March 1997, addressed to Atty. Demosthenes B. Donato.

Accordingly, there is no need to determine foreign equity participation in CMPI Holdings' ownership structure for purposes of compliance with the nationality restrictions imposed by the Constitution and other pertinent laws as said corporation is not engaged in a nationalized or partly nationalized activity. Consequently, there is no citizenship requirement demanded of the members of CMPI Holdings' Board of Directors.

Meanwhile, CMPI Land's latest Articles of Incorporation filed with the SEC shows that one of its primary purposes is to acquire real properties including lands, *viz* –

> To acquire by purchase, exchange, assignment, gift or otherwise, and to hold, own and use for investment or otherwise, To (sic) acquire by purchase, lease, exchange, donation, or otherwise, as may be permitted by law, real and personal properties of every kind and description, whether improved or unimproved, and any interest or right therein; to own, control, maintain, administer, develop and hold for investment or otherwise said real properties; to erect, construct, maintain, improve, rebuild, enlarge, alter and administer shops, factories, machinery and plants, offices, buildings of any nature and for any purpose, and structures of any description of any lands owned, held or leased by the Corporation; to lease or sublet offices, stores, shops and other space in such building or buildings and structure or structures; and to sell, lease, sublet, mortgage, exchange, assign, transfer, convey, or otherwise alienate or dispose of any of its properties, and any interest or right therein subject to such limitations as may be provided by law.

Under the FIA and the FINL, the acquisition of private lands is partially reserved to Philippine nationals wherein foreign equity participation is limited only to forty percent (40%). The same restriction is mandated by Section 7, Article XII of the Constitution[7] and Section 22, Chapter IV of Commonwealth Act No. 141 in the acquisition of private lands and disposable lands of public domain.[8]

Accordingly, the capacity of CMPI Land to own land within Philippine territory is subject to the forty percent (40%) threshold in foreign equity participation because acquisition and ownership of land is a partly nationalized activity.

Consequently, Section 2-A of the Anti-Dummy Law allows foreigners to have, at the most, four (4) out of the nine (9) seats available in the Board of Directors of CMPI

[7] Section 7. Save in cases of hereditary succession, no private lands shall be transferred or conveyed except to individuals, corporations or associations qualified to acquire or hold lands of the public domain.
[8] Section 22. Any citizen of lawful age of the Philippines, and any such citizen not of lawful age who is a head of a family, and any corporation or association of which at least sixty per centum of the capital stock or of any interest in said capital stock belongs wholly to citizens of the Philippines, and which is organized and constituted under the laws of Philippines, and corporate bodies organized in the Philippines authorized under their charters to do so; may purchase any tract of public agricultural land disposable under this Act, not to exceed one hundred and forty-four hectares in the case of an individual and one thousand and twenty-four hectares in that of a corporation or association, by proceeding as prescribed in this chapter; Provided, That partnerships shall be entitled to purchase not to exceed one hundred and forty-four hectares for each member thereof. But the total area so purchased shall in no case exceed the one thousand and twenty-four hectares authorized in this Section for associations and corporations.

Land. Note, however, that in determining the representation of foreign stockholders in the Board of Directors of a corporation engaged in a partly nationalized activity, the basis is the actual share of the foreign stockholders.[9]

As earlier explained, the determination of the eligibility of a corporation, which has foreign equity participation in its ownership structure, to engage in a nationalized or partly nationalized activity would require the application of either the Control Test or the Grandfather Rule. However, the determination of which between these two tests is applicable in CMPI Land's case would necessitate the determination of factual issues and should be the subject of a proper case or proceeding. Thus, as a matter of policy, the Commission shall refrain from rendering an Opinion on the said matter pursuant to SEC Memorandum Circular No. 15, series of 2003.

Nonetheless, in applying the Control Test on the aforementioned facts and on the following assumptions: (a) ALI is 100% Filipino-owned or at least 60% Filipino-owned; (b) Cementhai is 100% Thai-owned; and (c) Lafarge is 100% British-owned, the total foreign equity participation in CMPI Land is forty percent (40%) comprising of the 20% shares of Cementhai and the 20% shares of Lafarge.

On the other hand, using the same facts and the assumption that ALI is 100% Filipino-owned, the Grandfather Rule may be applied as follows:

Foreign/Filipino equity in CMPI Land	=	Sum of [(% share in CMPI Land of investing corporation) * (% of Foreign/Filipino equity of investing corporation)]

Example:

Foreign equity in CMPI Land:

a. CMPI Holdings	(60%)(40%)	=	24%
b. Cementhai	(20%)(100%)	=	20%
c. Lafarge	(20%) (100%)	=	20%
			64%

Filipino equity in CMPI Land:

a. CMPI Holdings	(60%)(60%)	=	36%
b. Cementhai	(20%)(0%)	=	0%
c. Lafarge	(20%)(0%)	=	0%
			36%

Accordingly, the total foreign equity participation in CMPI Land using the Grandfather Rule under the given facts and assumptions is sixty-four percent (64%).

The foregoing opinion is rendered based solely on the facts disclosed in the query and relevant solely to the particular issues raised therein and shall not be used in

[9] SEC Opinion No. 03-50 dated 23 October 2003, addressed to Mr. Yasutaka Honda.

the nature of a standing rule binding upon the Commission whether of similar or dissimilar circumstances.[10] If, upon investigation, it will be disclosed that the facts relied upon are different, this opinion shall be rendered void.

CAMILO S. CORREA
General Counsel

[10] SEC Memorandum Circular No. 15, series of 2003.