



Philippines

Foreign ownership rules in the Philippines

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C H A N C E



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In April 2014, the Philippine Supreme Court banned three mining companies from the exploration and development of the country's natural resources for violating the 60-40 ownership limit dictated by the law. This is just one of a number of high profile cases that have shaped the current law on foreign ownership in the Philippines. This bulletin provides an overview of the Supreme Court's decision and explores the implications for foreign owners.

The Supreme Court ruled that Narra Nickel Mining and Development Corp., Tesoro Mining and Development Inc. and McArthur Mining Inc. had breached the 60-40 ownership limit. However, this landmark decision appears to contradict an earlier decision creating uncertainty as to how investors should invest in nationalised entities.

Law on foreign ownership

The Philippine Constitution contains a number of foreign ownership requirements, one of the most prominent of which is enshrined in Section 2 of Article XII.

ARTICLE XII

National Economy and Patrimony [...] SECTION 11.

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

There are foreign investment restrictions in a number of

important activities in the Philippines. Particularly relevant are, in addition to the Constitutional foreign investment restrictions on the exploration, development and utilization of natural resources in co-production, joint venture or production-sharing agreement with the State, similar requirements for the ownership of private land, use of land of the public domain and the operation of public utilities. These activities are reserved for Filipinos, or corporations or associations not more than 40% of whose capital is owned by non-Filipinos.

These requirements are mirrored in important laws and regulations in the field of administrative law, including the Foreign

Investments Act and the BOT Law. The Foreign Investments Act pertinently defines the term "Philippine national" as follows:

SECTION 3: Definitions as used in this Act:

The term "Philippine national" shall mean a citizen of the Philippines or a domestic partnership or association wholly owned by citizens of the Philippines; or a corporation organized under the laws of the Philippines of which at least sixty percent

Key issues

- The issue had always been how to interpret "...Filipino citizens, or corporations or associations at least sixty per centum of whose capital is owned by such citizens.."
- Recent Supreme Court decisions have brought about important changes.
- It is unclear which interpretation shall prevail as the Narra Nickel decision conflicts with Bayantel.
- Filipino and non-Filipino partners seeking to invest in a nationalized entity should structure as conservatively as possible.

(60%) of the capital stock outstanding and entitled to vote is owned and held by citizens of the Philippines; or a corporation organized abroad and registered as doing business in the Philippines under the Corporation Code of which one hundred percent (100%) of the capital stock outstanding and entitled to vote is wholly owned by Filipinos; or a trustee of funds for pension or other employee retirement or separation benefits, where the trustee is a Philippine national and at least sixty (60%) of the fund will accrue to the benefit of the Philippine nationals: Provided, That where a corporation and its non-Filipino stockholders own stocks in a Securities and Exchange Commission (SEC) registered enterprise, at least sixty percent (60%) of the capital stocks outstanding and entitled to vote of each of both corporations must be owned and held by citizens of the Philippines and at least sixty percent (60%) of the members of the Board of Directors of each of both corporations must be citizens of the Philippines, in order that the corporations shall be considered a Philippine national;

This requirement is further mirrored in a criminal law, i.e. the so-called Anti-Dummy Law, that extends criminal liability to, among other things, (1) falsely simulating the existence of "such minimum stock or capital as owned by" Philippine citizens, (2) permitting or allowing non-qualified persons to exploit or enjoy a privilege expressly reserved by the Constitution or laws to citizens of the Philippines or to corporations or associations at least sixty per centum of the capital of which is owned by such citizens, (3) permitting or allowing non-qualified persons "to intervene in the management, operation, administration or control [of reserved businesses], whether as an officer, employee or laborer therein with or without remuneration", or (4) to "any person who knowingly aids, assists or abets in the planning, consummation or perpetration of any of the acts" enumerated therein.

The foreign ownership requirement has been subject to numerous administrative announcements in the form of the 1967 SEC Rules as well as in the form of opinions issued and published by the Department of Justice ("DOJ") and the Securities and Exchange Commission ("SEC") that interpreted the constitutional rule. Although such rules and opinions do not enjoy the force of law, these announcements used to be attributed the highest level of authority and they used to serve as trusted guidelines for the structuring of many Philippine investments with a foreign element. While the interpretation of the constitutional requirements appeared well settled for more than two decades, a number of recent decisions by the

Philippine Supreme Court brought about important changes. Unfortunately, those new decisions, including one by the Supreme Court en banc and two by different Divisions of the Supreme Court, are not fully consistent in several respects, leading to different sets of interpretations, in relation to which it remains unclear which interpretation shall finally prevail.

In the meantime, Philippine and foreign investors are left in uncertainty about the legal framework for their investments. Bearing in mind that non-compliance with the relevant framework may constitute a criminal offence punishable with up to 15 years of imprisonment and by a fine of not less than the value of the right, franchise or privilege enjoyed or acquired in violation of the relevant provisions, the safest way for new investments is to comply with all rules that might possibly apply, while existing investments might require a restructuring if compliance with the existing rules is no longer free of doubt. The change of the legal framework for existing investments gives rise also to issues of investment protection.

The Narra Nickel decision

The Philippine Supreme Court, in its decision promulgated on April 21, 2014 in **Narra Nickel et al, v. Redmont ("Narra Nickel")**, has interpreted anew the nationality restriction set forth in the Philippine Constitution, particularly in respect of testing the nationality of indirect investments in the capital of an entity engaged in a nationalized activity. The decision in Narra Nickel, however, conflicts with the decision of the Philippine Supreme Court in *In Re Bayantel* ("Bayantel"), thereby leaving continuing uncertainty on the manner by which indirect investments in a nationalized entity are to be attributed between Filipinos and non-Filipinos.

Historical interpretation of the foreign ownership rules

The issue had always been how to correctly interpret the phrase "...Filipino citizens, **or corporations or associations at least sixty per centum of whose capital is owned by such citizens...**" For many years, two regulators, the DOJ and the SEC took the lead in interpreting the phrase in various opinions and rulings. And a significant part of the various opinions issued by the DOJ and the SEC may be grouped into two major themes:

- What is meant by "capital"? Before *Gamboa v. Teves et al.* ("Gamboa"), the SEC and the DOJ interpreted capital to mean "outstanding capital stock". Thus, the

relevant percentages shall be determined on the basis of the number of outstanding shares, without regard as to nomenclature or classification as common/ preferred, voting/ non-voting, or irrespective of the amount of the par value of the shares. In Gamboa, the Supreme Court ruled that “capital” shall mean shares of stock entitled to vote in the election of directors, and not just to the total outstanding capital stock (the “Gamboa Voting Control Test”).

- How compliance with the nationality requirement must be tested in ownership structures where Filipinos and non-Filipinos have direct and indirect (through corporate investments layers) ownership in the capital of the nationalized entity. In testing the nationality of shares indirectly held by non-Filipinos in a nationalized entity, the so-called Control Test and the so-called Grandfather Rule will apply, as applicable. In jargon, the Control Test has also been referred to as the “Liberal Rule”, although it is not necessarily more liberal. Depending on the structure the most liberal results may be achieved by combining elements of both rules as can be seen in several structures on which the DOJ affirmatively opined. The origin of these two rules is the rule promulgated by the SEC in February 28, 1967 (the “1967 SEC Rules”) to implement the constitutional and statutory requirements that the controlling interests of enterprises engaged in the exploitation of natural resources should be held by citizens of the Philippines or by corporations or associations at least 60% of the capital of which is owned by such citizens. Paragraph 7 of the 1967 SEC Rules provides:

“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.”

The Control Test pertains to that portion of Paragraph 7 of the 1967 SEC Rules which states:

- “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... 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 Filipino

citizens, all of the said shares shall be recorded as owned by Filipinos.”

Illustration 1 demonstrates how the Control Test would be applied to a layered structure with one holding company.

In other words, the level at which the Control Test is met will no longer be pierced to determine prorated Filipino and non-Filipino ownership. All shares held by the entity that satisfies the Control Test are deemed as held by Filipinos, without regard as to the Filipino and non-Filipino ownership of the entity that owns such shares. This same principle is followed in treating all shares held by a “Philippine National” (as such term is defined in the Foreign Investments Act) as Filipino-held shares, to the extent that the term “Philippine National” is defined to include “...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” and “where a corporation and its non-Filipino stockholders own stocks in a Securities and Exchange Commission (SEC) registered enterprise, at least sixty percent (60%) of the capital stock outstanding and entitled to vote of each of both corporations must be owned and held by citizens of the Philippines and at least sixty percent (60%) of the members of the Board of Directors of each of both corporations must be citizens of the Philippines, in order that the corporation shall be considered a Philippine national.”

The Grandfather Rule, on the other hand, is that portion of 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...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.”

Illustration 2 demonstrates how the Grandfather Rule would be applied under paragraph 7 of the 1967 SEC Rules.

- If the 60% Filipino ownership threshold under the Control Test is not met, the Grandfather Rule will be applied such that the prorated indirect shareholding of non-Filipinos will be determined and added to any direct non-Filipino shareholding, to determine the total non-Filipino shareholding in the nationalized entity. For

this purpose, each entity at which the 60% Filipino ownership threshold under the Control Test is not met will be pierced, to determine the proportional Filipino and non-Filipino ownership, and such proportion shall be applied for the purpose of determining the nationality of shares owned by such entity. It must be emphasized that under the 1967 SEC Rules, the Grandfather Rule will be applied only when the threshold for the Control Test is not met, that is, only when the Filipino shareholding in the corporation is below 60% of the capital.

- In sum, under the 1967 SEC Rules, there is a two-step analysis. First, it must be determined if the 60% Filipino ownership threshold is met at each layer or level of the structure. If yes, the analysis ends and the subject corporation will be deemed a qualified entity by virtue of the Control Test. Second, if the 60% Filipino ownership threshold is not met and thus the 60-40 Filipino-foreign equity ownership is considered "in doubt", the Grandfather Rule will be applied to ascertain whether, ultimately, the direct and indirect shareholdings of Filipinos add up to at least 60% in order to meet the nationality requirement. If the direct and indirect shareholdings of Filipinos do not add up to at least 60%, then the subject corporation will not be considered a qualified entity.
- However, it must be stressed that even if the 60% threshold for the application of the Control Test is not met and the Grandfather Rule is applied, it is possible that the nationality requirement may be met such as in cases where the direct and indirect shareholdings of Filipinos still add up to at least 60%, even if no entity in the structure is 60% directly owned by Filipinos. Please refer to Illustration 3 for a situation where the application of the Grandfather Rule may still result in meeting the 60% nationality requirement even if no entity in the structure is 60% directly owned by Filipinos.
- At this point, it must be emphasized that the 1967 SEC Rules – contrary to a common perception frequently expressed – did not drop but continued to recognize the applicability of the Grandfather Rule, albeit only in situations where the 60% threshold for the applicability of the Control Test is not met. The 1967 SEC Rules recognizes that if the said threshold is not met, the 60-40 Filipino-foreign equity ownership will become "in doubt" and resort to the Grandfather Rule must be made and each corporate entity at each level must be pierced and its shareholders determined to ascertain

whether, ultimately, the direct and indirect shareholdings of Filipinos add up to at least the 60% level required. The 1967 SEC Rules effectively suppressed a straightforward application of the Grandfather Rule and only required its application to situations where the 60% threshold for the applicability of the Control Test is not met. Illustration 4 is a demonstration of how a structure that passes the Control Test hypothetically would have been tested (and would fail) under the Grandfather Rule. The 1967 SEC Rules does not contemplate the immediate application of the Grandfather Rule in analyzing compliance with the nationality requirement. It requires first the determination of whether the 60% threshold for the application of the Control Test has been met. If it has been met, there will be no room for the application of the Grandfather Rule. On the other hand, if the threshold is not met, the application of the Grandfather Rule becomes inevitable.

Narra Nickel

- The issue in Narra Nickel was the qualification of three entities with Filipino and non-Filipino ownership to engage in mining. The nationality restriction is found in the Constitutional provision which limits the exploration, development and utilization of natural resources in co-production, joint venture or production-sharing agreement with the State to Filipinos, or corporations or associations not more than 40% of whose capital is owned by non-Filipinos. A similar nationality restriction is found in Republic Act No. 7942 or the Philippine Mining Act of 1995.
- Narra Nickel was landmark because it was the first time that the Supreme Court was called upon to confirm the validity of the 1967 SEC Rules as the test of the nationality of indirect investments in the capital of a nationalized entity. The Supreme Court ruled that the Control Test is still the "prevailing mode" of testing the nationality of such indirect investments in the context of the Constitutional nationality restriction on exploration, development and utilization of natural resources. However, "[W]hen 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 the Court may apply the Grandfather Rule.
- The Supreme Court in Narra Nickel has taken the 1967 SEC Rules further. As discussed earlier, under the

1967 SEC Rules, the Grandfather Rule is applied only when the 60% Filipino ownership threshold under the Control Test is not met. However, in *Narra Nickel*, the Supreme Court justified the application of the Grandfather Rule when there is doubt in the 60/40 Filipino/non-Filipino ownership “based on the attendant facts and circumstances of the case”. So even though the ownership structure of the subject corporations appeared to comply with the Control Test based on the number of shares (60/40) at each of the operating company and holding company levels and arguably would not have been grandfathered under the previous regulatory interpretation of “in doubt”, the Supreme Court grandfathered, citing particularly (a) unpaid Philippine national equity at the holding company level, and (b) declarations in financial statements that the non-Filipino partner holds directly and indirectly an effective equity interest of more than 60.4% (which necessarily results if you allow for corporate layering) as well as that the foreign partner exercises “joint control” over the nationalized companies.

- Under the interpretation prevailing before *Narra Nickel*, the question whether the 60-40 Filipino-foreign equity ownership may also be “in doubt” if the 60% Filipino ownership threshold under the Control Test has been met was answered in the negative, bearing in mind that the Foreign Investments Act had incorporated the Control Test. It should be noted that the theory now adopted by the Supreme Court according to which “doubt” leads to the applicability of a different set of rules – potentially with criminal law consequences – may conflict with the criminal law principle “in dubio pro reo”, an issue that has not yet been widely discussed in the Philippines as *Narra Nickel* has not been a criminal case.

Narra Nickel conflicts with Bayantel

- In *Bayantel*, the Supreme Court (through a different Division), rejected the debt-to-equity conversion proposed by the non-Filipino creditors of *Bayantel*, a public utility, on the ground that the same would result in 77% non-Filipino ownership of *Bayantel*. While not expressly stating that the Control Test is invalid or incorrect, the *Bayantel* Court effectively applied the Grandfather Rule, and disregarded the Control Test as submitted by the non-Filipino creditors. The Supreme Court, thus, did not consider as Filipino-held the 40%

of shares of foreign creditors in the holding company that shall retain, on a direct basis, the 60% equity of *Bayantel* following the Control Test. Under the Control Test, such 40% shares of foreign creditors in the holding company will be deemed as Filipino-held as long as 60% of the holding company is owned by Filipinos, which is the necessary result of the first step of the two-step analysis in the 1967 SEC Rules. But in *Bayantel*, the Court effectively considered such 40% as held by non-Filipinos and prorated the same vis-à-vis the shares held by the holding company in *Bayantel* to arrive at a conclusion that the nationality requirement will be breached. The Court, thus, applied the Grandfather Rule in a straightforward manner and disregarded the first step embodying the Control Test in the two-step analysis under the 1967 SEC Rules.

- The straightforward application of the Grandfather Rule in *Bayantel* conflicts with the *Narra Nickel* rule, which called for the application of the Control Test (rather than a straightforward application of the Grandfather Rule in *Bayantel*), and the application of the Grandfather Rule only when there is doubt “based on attendant facts and circumstances.” Both *Bayantel* and *Narra Nickel* decisions were promulgated by different Divisions of the Supreme Court. As a general rule, neither decision should take precedence over the other. However, it must be stressed that any doctrine or principle of law laid down by the Supreme Court, either rendered en banc or in division, may be overturned or reversed only by the Supreme Court sitting en banc. The issue now is whether or not the *Bayantel* ruling laid down a doctrine that may only be overturned by a decision of the Supreme Court en banc.
- The *Bayantel* decision is final and non-appealable and may no longer be modified. On the other hand, we understand that the petitioners have moved for reconsideration of the *Narra Nickel* decision. If *Narra Nickel* is not referred to the Supreme Court en banc either by a party-litigant, on motion, or by the Third Division of the Supreme Court, motu proprio, the Supreme Court en banc will have no basis to take cognizance of the case. Accordingly, the motion for reconsideration will be decided by the Third Division and unless the Third Division follows the *Bayantel* ruling, the conflicting decisions of two different Divisions of the Supreme Court will remain unresolved. On the other hand, a resolution of the Supreme Court in *Narra Nickel*, sitting en banc, will have the effect of revoking the rule in *Bayantel* to the extent that the

latter is inconsistent with such Supreme Court en banc's resolution.

- We believe that the apparent conflict in the rulings in these cases is sufficient ground for the Supreme Court to step in as a court sitting en banc in order to resolve the conflict once and for all.

Effect of Supreme Court Decisions

Final and non-appealable decisions of the Supreme Court form part of Philippine law and thus become part of the "the law of the land".

Summary of rules

To date, in testing compliance with the nationality requirement, inter alia the following – partly conflicting – rules need to be considered:

Gamboa Voting Control Test

In Gamboa, the Supreme Court ruled that the term "capital" in the constitutional provision refers to shares of stock entitled to vote in the election of directors, and not merely to the outstanding capital stock. The Court rejected the previous SEC and DOJ interpretation of "capital" as the total outstanding capital stock of the corporation, without regard as to its classification into voting and non-voting shares.

Additional test under SEC Guidelines (Total Shares Test)

SEC Memorandum Circular No. 8, series 2013 also requires that, in addition to the Gamboa Voting Control Test, at least 60% of the total number of outstanding shares of stock (whether or not entitled to vote in the election of directors; without regard to classification) in the nationalized entity must be held by Philippine nationals (the "Total Shares Test").

Bayantel or Narra Nickel? Do you grandfather immediately or only when there is "doubt"?

Given the conflicting decisions of the Supreme Court in Bayantel and Narra Nickel, the dilemma is whether to apply Bayantel and test the nationality of indirect ownership using the Grandfather Rule immediately, or to apply the two-step analysis of Narra Nickel; i.e. to determine whether the structure passes the Control Test, and to apply the Grandfather Rule only when there is doubt "based on attendant facts and circumstances of the case."

Until the conflict between Bayantel and Narra Nickel is resolved, hopefully by a resolution issued by the Supreme Court en banc on the motion for reconsideration filed in Narra Nickel, the safe bet would be to ensure compliance with both tests.

Other Rules

It should be noted that the issues discussed above represent only one aspect of the determination of ownership to meet the constitutional and other legal requirements, and that other structural elements such as trust relationships, and compliance with other laws including the structural requirements of the Anti-Dummy Law are equally indispensable.

Sanctions for non-compliance and cure periods

- Violations of the foreign ownership restrictions are subject to multiple sanctions, including possible criminal sanctions under the Anti-Dummy Law that may entail the dissolution of the corporation in question, imprisonment of up to 15 years, a fine of not less than the value of the right in violation of the provisions thereof, and forfeiture of the right or privilege that is subject of the nationality requirement.
- The Supreme Court in Gamboa did not establish any general cure periods for investments that may be regarded non-compliant under the new interpretation, but stated:
 - *"Under prevailing jurisprudence, public utilities that fail to comply with the nationality requirement under Section 11, Article XII and the FIA [Foreign Investments Act] can cure their deficiencies prior to the start of the administrative case or investigation."*
- However, it should also be noted that in Narra Nickel, the Supreme Court treated the fact that a change in structure had been brought about, as additional proof that the previous structure was non-compliant.
- The Gamboa decision is silent whether the possibility to cure structural deficiencies only relates to administrative cases or investigations or whether a cure also includes immunity or protection from potential criminal liability.

Challenge on SEC Memorandum Circular No. 8 series 2013

- Five lawyers have sued in the Supreme Court to partially invalidate SEC Memorandum Circular No. 8, series 2013. Based on publicly available information, the petitioners seek invalidation of SEC Memorandum Circular No. 8, series 2013, to the extent that it does not implement the Supreme Court's pronouncement that the 60-40 requirement must be applied to each class of shares created by a nationalized entity. We had noted in an earlier briefing that the Supreme Court's pronouncement in Gamboa in this regard was a non-binding obiter dictum. To implement such obiter dictum and to test the 60-40 requirement separately on each class of shares would make it impossible to create or maintain any class of shares equipped with a different set of features in which non-Filipinos hold more than 40%.
- A common mode of structuring frequently found in practice would be to create different classes of shares with different economic rights, and to reserve the class of shares with superior economic (par value/ dividends) rights for non-Filipino investors who are willing to infuse more funds than their Filipino counterparts, while still maintaining the 60-40 requirement on total outstanding capital stock or on total voting shares. See Illustration 5 for a simple example of such a structure. If the Supreme Court upholds the five lawyers' petition and makes doctrine what was otherwise an obiter dictum of Gamboa, such structuring would not be legal anymore.

Conclusion

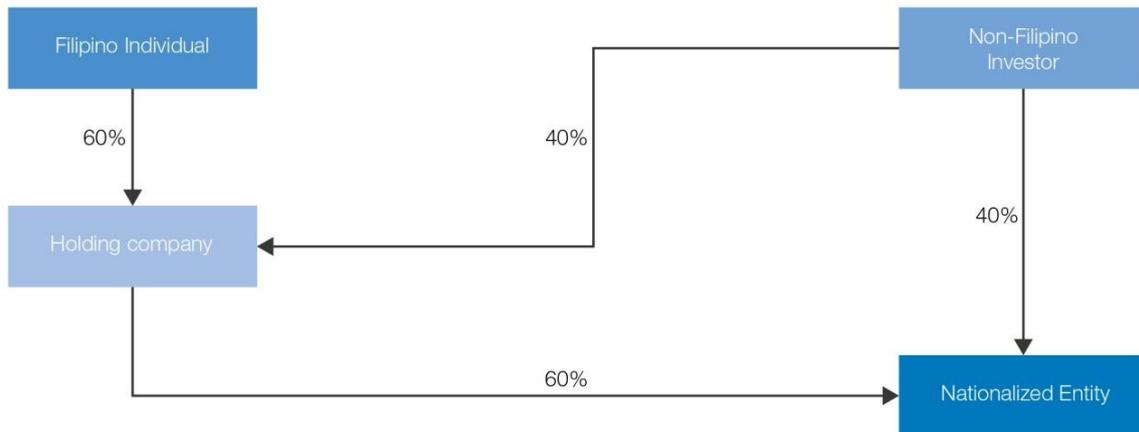
- With the pending motion for reconsideration filed in Narra Nickel and the pending petition challenging SEC Memorandum Circular No. 8, series 2013, the nationality rules of the Philippines are still very much in flux. There could be more certainty on these rules once Narra Nickel becomes final and non-appealable and the Supreme Court rules on the petition challenging the validity of SEC Memorandum Circular No. 8, series 2013.
- Meanwhile, Filipino and non-Filipino partners seeking to invest in a nationalized entity should structure as

conservatively as possible. This means complying with the Gamboa Voting Control Test and the Total Shares Test, and structuring indirect investments on the basis of the Grandfather Rule. If a structure of indirect investment on the basis of the Control Test is desired, we recommend that the same be structured as conservatively as possible (i.e., minimal minority protection rights, fully-paid Filipino equity), so as to preclude a court from exercising its broad discretion under Narra Nickel of applying the Grandfather Rule because there is "doubt" in compliance with the 60-40 requirement based on attendant facts and circumstances.

If you have concerns about your investment in the Philippines, we would be happy to discuss, in cooperation with Philippine counsel, the specific effect of the aforementioned recent developments on your investment and what you can do to protect your interests.

Illustration 1

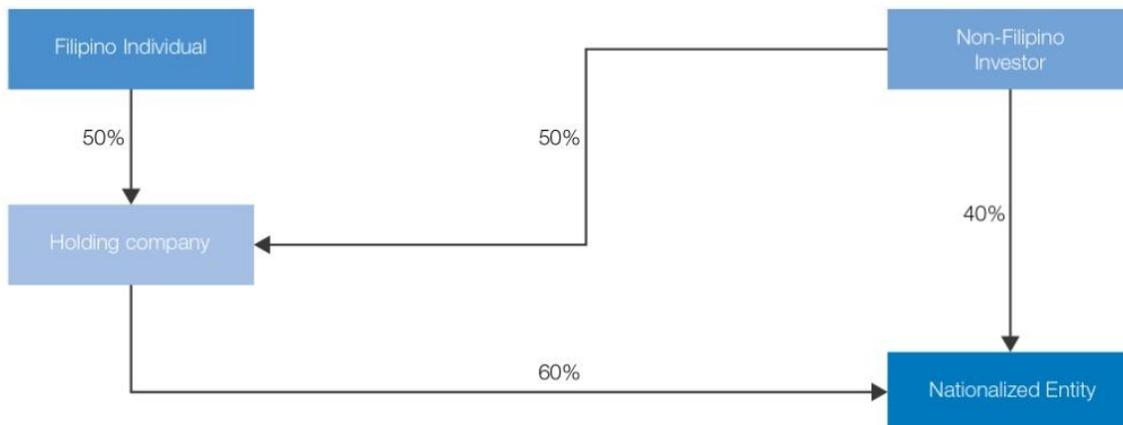
Illustration of the Control Test



Holding Company is a "Philippine national". Under the Control Test, its entire shareholding in the Nationalized Entity is deemed as Filipino-held.

Illustration 2

Illustration of the Grandfather Rule

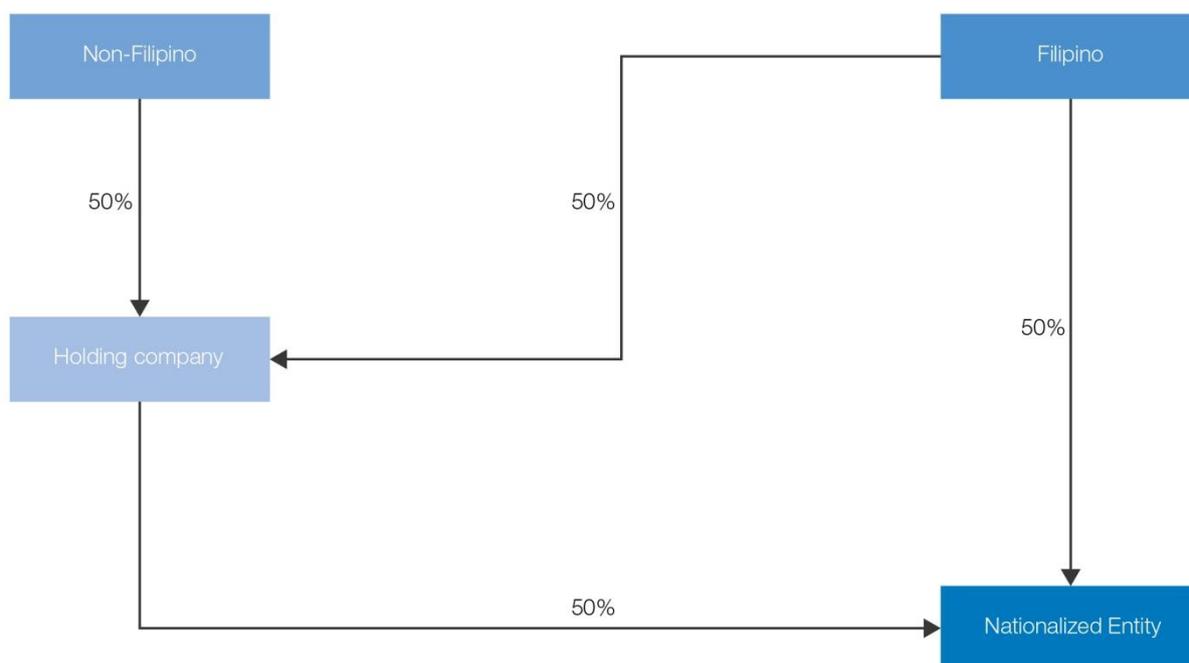


Applying the Grandfather Rule:

1. Total Filipino capital at Nationalized Entity = $60\% \times 50\% = 30\%$
2. Total non-Filipino capital at Nationalized Entity:
 Direct: 40%
 Indirect: $60\% \times 50\% = 30\%$
 Total: $40\% + 30\% = 70\%$

Illustration 3

Demonstration of an entity that qualifies based on the Grandfather Rule



Under the 1967 SEC Rules, the Grandfather Rule will be applied to the above structure. Thus, the nationality of shares held at the level of the Nationalized Entity shall be as follows:

Non-Filipino = 25% (indirect; 50% of 50%)

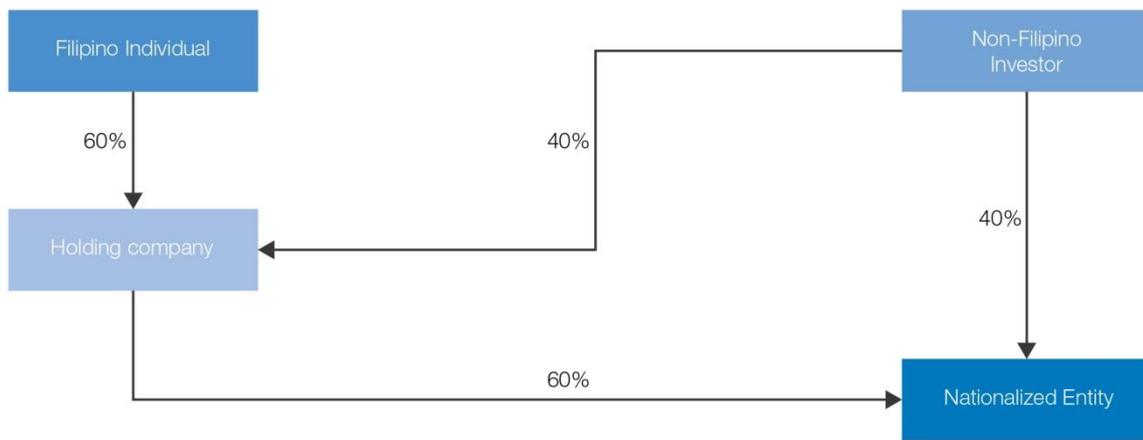
Filipino = 75%

50% (direct) and 25% (indirect; 50% of 50%)

Notwithstanding the application of the Grandfather Rule in this illustration, the direct and indirect shareholdings of Filipinos still add up to more than the 60% requirement (i.e., 75%).

Illustration 4

Applying the Grandfather Rule hypothetically to a structure that Passes the Control Test

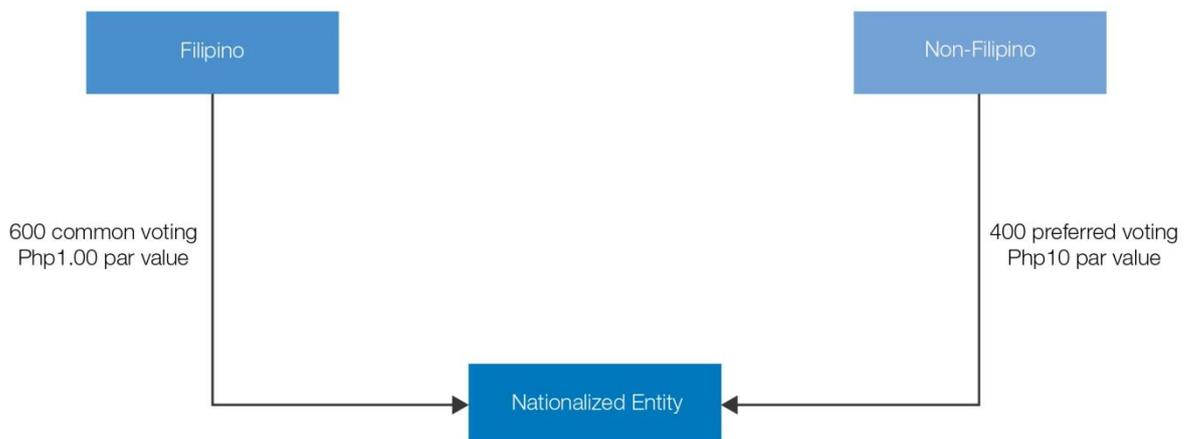


Applying the Grandfather Rule:

1. Total Filipino capital at Nationalized Entity = $60\% \times 60\% = 36\%$
2. Total non-Filipino capital at Nationalized Entity:
 - Direct: 40%
 - Indirect: $60\% \times 40\% = 24\%$
 - Total: $40\% + 24\% = 64\%$

Illustration 5

High Par/Low Par



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Contacts

Castillo Laman

Teodulo G. San Juan Jr.

Partner

T: +63(2)8131087

E: butch.sanjuan@cltps.com.ph

Louie Alfred G. Pantoni

Partner

T: +63(2)8176791

E: louie.pantoni@cltps.com.ph

Clifford Chance

Dr. Dietrich F. R. Stiller

Partner

T: +49 1712250027

E: dietrich.stiller@cliffordchance.com

Paul Landless

Partner

T: +65 6410 2235

E: paul.landless@cliffordchance.com

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Clifford Chance, Sindhorn Building Tower 3, 21st Floor, 130-132 Wireless Road, Pathumwan, Bangkok 10330, Thailand

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