Joint Foreign Chambers of the Philippines

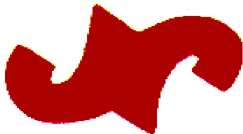
American Chamber of Commerce of the Phils., Inc. ◆ Australian-New Zealand Chamber of Commerce (Phils.), Inc.
Canadian Chamber of Commerce of the Phils., Inc. ◆ European Chamber of Commerce of the Phils., Inc.
Japanese Chamber of Commerce & Industry of the Phils., Inc. ◆ Korean Chamber of Commerce of the Phils., Inc.
Philippine Association of Multinational Companies Regional Headquarters, Inc.

AMERICAN

AUSTRALIAN-NEW ZEALAND

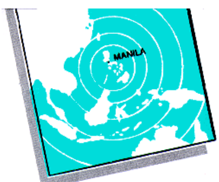
CANADIAN

EUROPEAN



JAPANESE

KOREAN



PAMURI

July 19, 2011

FOREIGN INVESTMENT IN PUBLIC INFRASTRUCTURE

> *"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; nor shall such franchise, certificate, or authorization be exclusive in character or for a longer period than fifty years. Neither shall any such franchise or right be granted except under the condition that it shall be subject to amendment, alteration, or repeal by the Congress when the common good so requires. The State shall encourage equity participation in public utilities by the general public. The participation of foreign investors in the governing body of any public utility enterprise shall be limited to their proportionate share in its capital, and all the executive and managing officers of such corporation or association must be citizens of the Philippines."*
>
> \- 1987 Constitution, Article XII, Section 11

The above language in the Constitution imposes nationality requirements on the operation and management of public utilities, reserving these areas to citizens, or in the case of corporations, those whose capital is at least sixty percent (60%) owned by Philippine citizens, with the remaining forty percent (40%) open to foreign ownership. This provision recognizes the important role of public utilities in the national economy and the need to secure the national interest in utilities against foreign influence.

Be that as it may, one of the most urgent national priorities is to modernize major infrastructure, thereby improving national competitiveness and stimulating investment and job creation. Because this goal is a cornerstone of the Aquino Administration, there is a need to understand better how the constitutional provision provides a flexible framework within which foreign investment can operate.

Poor infrastructure has repeatedly been cited as a leading reason why investment – both domestic and foreign – is currently too low to sustain a fast-growing national economy. Without adequate investment and job creation, millions of Filipinos have had no other choice than to seek employment abroad, often incurring the hardship of family separation. The Aquino administration itself recognizes the need to tap public-private partnerships (PPP) in order to accelerate the financing, construction, and operation of vital government infrastructure projects.

This briefing memo discusses how to maximize foreign investor participation without overstepping the bounds set by the Philippine Constitution. Fortunately, statutes and judicial precedents are in place that can serve as guides for future projects.

Public Utilities

Philippine jurisprudence gives us a working definition of a public utility, that it is a business or service engaged in regularly supplying the public with some commodity or service of public consequence such as electricity, gas, water, transportation, telephone or telegraph service.[1] While there is no one law that definitively catalogs the industries considered as public utilities, this definition, taken together with the list of public services described in Commonwealth Act No. 146, otherwise known as the Public Service Act, has served since its passage in 1936 as the standard by which a public utility is identified.

On the other hand, there are certain sectors that are not considered public utilities by operation of law. For example, **power generation[2] and supply of electricity** to the contestable market[3] are not considered public utility operations by virtue of the Electric Power Industry Reform Act of 2001.[4] A **shipyard**, which was once included as a public utility under the Public Service Act, is no longer considered a public utility as a result of a series of statutory repeals.[5] And **refining of imported crude oil**, as opposed to refining petroleum that is indigenous to the Philippines, is not within the activities considered as "public utility" within the contemplation of Republic Act No. 387 (the Petroleum Act of 1949).[6] Since these industries are not within the domain of public utilities, it follows that the **nationality restriction does not apply, thereby paving the way for up to one hundred percent (100%) foreign ownership in these areas**.

Operation v. Ownership

While the Constitution absolutely requires a franchise or other form of authorization for the operation of a public utility, it does not impose such a requirement over mere ownership of the facilities needed for its operation. Otherwise stated, the Constitution does not impose any franchise requirement – and therefore no nationality restriction – on the ownership of facilities used to serve the public.

---

[1] JG Summit Holdings, Inc. v. Court of Appeals, G.R. No. 124293. September 24, 2003

[2] Section 6. Xxx Any law to the contrary notwithstanding, power generation shall not be considered a public utility operation. For this purpose, any person or entity engaged or which shall engage in power generation and supply of electricity shall not be required to secure a national franchise. xxx

[3] Section 29. Xxx Any law to the contrary notwithstanding, supply of electricity to the contestable market shall not be considered a public utility operation. For this purpose, any person or entity which shall engage in the supply of electricity to the contestable market shall not be required to secure a national franchise. xxx

[4] Republic Act No. 9136, June 8, 2001.

[5] See JG Summit Holdings, Inc. v. Court of Appeals, G.R. No. 124293. September 24, 2003

[6] Bagatsing v. Committee on Privatization, G.R. No. 112399, July 14, 1995.

This dichotomy between operation and ownership of public utilities is well settled in Philippine jurisprudence, and clearly articulated in the case of *Tatad v. Garcia*[7] where the **Supreme Court held that**

> ***"[t]he right to operate a public utility may exist independently and separately from the ownership of the facilities thereof.*** *One can own said facilities without operating them as a public utility, or conversely, one may operate a public utility without owning the facilities used to serve the public. The devotion of property to serve the public may be done by the owner or by the person in control thereof who may not necessarily be the owner thereof."*

The case involved the EDSA LRT III project (now known as EDSA MRT III), authorized under Republic Act No. 6957, more commonly known as the Build-Operate-Transfer law (the "BOT law"). The **court decided in favor of a foreign corporation's ownership over the EDSA LRT III**, explaining that what it owned was the rail tracks, coaches, rail stations, terminals, and the power plant, which by themselves do not constitute a public utility. The Department of Transportation and Communication undertook the operation of those facilities as a common carrier under a Build-Lease-Transfer scheme.

The Court's ruling in *Tatad* could well be applied to other public infrastructure projects undertaken through the BOT law. Since there is a clear distinction between the operation of a public utility and ownership over its facilities and equipment, then there should be no barrier to foreign ownership of such facilities and equipment for as long as operations are undertaken by an entity that meets the nationality requirement.

Conclusion

The Aquino administration is already cognizant of the critical role that foreign investment plays in financing, in whole or in part, priority infrastructure and development projects that are vital to the country's economic growth and future, especially since government and local private funding may be insufficient to meet capital needs. The administration has presented its priority Public Private Partnership projects to foreign business groups repeatedly to encourage them to invest, finance, build, and otherwise become involved in supporting this premier policy thrust to modernize the country's infrastructure. In spite of the constitutional restriction on foreign equity participation in public utility enterprises, it need not be seen as a barrier to the success of public-private partnership projects since there are legitimate options for moving this aspect of PPP policy forward. **By providing prospective foreign investors with viable options, we can revive investor interest in the country and fully realize the economic growth potential that the PPP policy holds.**

[7] G.R. No. 114222, April 6, 1995.

AUSTEN CHAMBERLAIN
President
American Chamber of Commerce
of the Philippines, Inc.

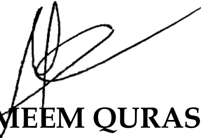
JOHN CASEY
President
Australian-New Zealand Chamber
of Commerce of the Philippines, Inc.

JULIAN PAYNE
President
Canadian Chamber of Commerce
of the Philippines, Inc.

HUBERT D'ABOVILLE
President
European Chamber of Commerce
of the Philippines, Inc.

N OBUYA ICHIKI
President
Japanese Chamber of Commerce
& Industry of the Philippines, Inc.

EUN GAP CHANG
President
Korean Chamber of Commerce
of the Philippines, Inc.



SHAMEEM QURASHI
President
Philippine Association of Multinational Companies
Regional Headquarters, Inc.