Philippine Depositary Receipts: Mass Media's Existing or Emerging Loophole To Constitutionally Mandated Full Filipino Ownership?

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Quando aliquid prohibitur ex directo, prohibitur et per obliquum.[1] What cannot be legally done directly cannot be done indirectly. If acts that cannot be legally done directly can be done indirectly, then all laws would be illusory.[2]

Need not be told that the State has and will always recognize the great importance of mass media in the stability and development of the nation. Mass media acts as "gate-keepers", the determining factor that decides whether or not a message can successfully flow from the transmitter to the receiver.[3] The State therefore has the duty to protect said industry, ensuring that the same is within the control of its citizenry and far from the fetching influence foreign control carries.

With the current trend of customization and diversification of financial instruments to heed the need of investments and thus entailing ways and machinations to suit the wants and demands of potential and existing investors, Philippine corporations engaged in mass media sought the use of Philippine Depositary Receipts (PDRs) to obtain foreign investment without being under the sanction of violating the constitution.

Hence, will the issuance of PDRs to foreigners, regardless of its underlying shares and whether the same will be exercised or not, curtail the Constitutional mandate of total Filipino ownership in mass media?

It is believed to be so.

Regardless of different scenarios pertaining to the issuance of PDRs of mass media corporations to foreigners such as whether the underlying shares are entitled to vote or not and whether the said PDRs are exercised or not, the primordial consequence of which is that the said PDRs will enable foreigners to control mass media corporations, a situation which was sought to be prevented by the Constitution.

Mass media corporations namely ABS-CBN, GMA and Rappler, even at the expense of recognizing the constitutional prohibition of foreign ownership in the industry of mass media, have acknowledged the ability of PDRs to obtain foreign investment, to wit:

> "The PDRs unlocked the share value of ABS-CBN, allowing foreigners to participate in a media enterprise whose ownership is constitutionally limited to Filipinos. With foreigners allowed to buy PDRs, ABS-CBN shares which have long been undervalued,

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1 *La Bugal-B'Laan Tribal Association, Inc. et al. vs. Ramos, et al.*, G.R. No. 127882, December 1, 2004.

2 *Tawang Multi-Purpose Cooperative vs. La Trinidad Water District*, G.R. No. 166471, March 22, 2011

3 The Mass Media in Business – Philippine Review of Economics by Purisima Katigbak-Tan, pre.econ.upd.edu.ph/index.php/pre/article/download/702/1

can now play catch-up with regional media counterparts."[4]

"Holders of the PDRs will enjoy only the economic benefits of the shares underlying the receipts without voting and other ownership rights. PDRs will allow foreigners to invest in a media enterprise whose ownership is constitutionally limited to Filipinos."[5]

"Rappler is the first and only media startup in the Philippines to join broadcasting network giants ABS-CBN and GMA in offering Philippine Depositary Receipts or PDRs to international investors. PDRs are financial instruments that foreign funds can buy into, allowing media and other Filipino firms that must keep foreign ownership at 40%, to raise funds globally."[6]

With said recognition, it is imperative to understand the nature and consequence of PDRs.

A Philippine Depositary Receipt(s) (PDR) is a security which grants the holder the right to the delivery of sale of the underlying share.[7] A PDR consists of a deposit price and an option price, which is considered as payment when the buyer opts to exercise his option of converting said PDRs to a corporation's share. PDRs are not evidences or statements nor certificates of ownership of a corporation.[8] However, each PDR represents a share, even in a restricted company, and when bought by a foreign entity, gives the buyer the right to all the dividends due the shares of stock acquired.[9]

Under International Accounting Standards 32.16, a financial instrument is an equity instrument only if (a) the instrument includes no contractual obligation to deliver cash or another financial asset to another entity, and (b) if the instrument will or may be settled in the issuer's own equity investments, it is either: (i) a non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; or (ii) derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments.[10]

PDRs therefore, even in an accounting perspective, are deemed to be considered as an equity instrument on the ground that the instrument will or may be settled using, in this case delivering, the issuer's (mass media corporation's) own equity investment or shares of stocks. The same fact was corroborated by one of Philippine's leading mass media corporation which recognized PDRs in its Financial Statement as part of its equity.[11]

Hence, being an equity instrument and enabling the holder thereof to be the ultimate recipient of the benefits accruing therein, i.e. dividends, PDRs indubitably has the ability to enable foreigners to exercise control over a media corporation despite absence of legal title to the same.

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4 http://www.abs-cbnpdr.com/pdr.php

5 *SEC gives go-signal for GMA's public offer*, June 20, 2007 -http://www.gmanetwork.com/news/story/47489/money/sec-gives-go-signal-for-gma-s-public-offer -

6 *Omidyar network invests in Rappler*, November 5, 2015 http://www.rappler.com/about-rappler/about-us/109992-omidyar-network-invests-rappler

7 Philippine Stock Exchange, Glossary - http://www.pse.com.ph/stockMarket/home.html#

8 Philippine Stock Exchange, Glossary - http://www.pse.com.ph/stockMarket/home.html#

9 The Manila Times: An Indonesian tycoon's media empire in the Philippines exposed, April 12, 2016.

10 *Roy vs. Herbosa*, G.R. No. 207246, November 22, 2016

11 *ABS-CBN 2014 Annual Report – Financial Statement* - http://corporate.abs-cbn.com/investorrelations/financial-and-operational-performance/view/vid-1436942064315/2014-abs-cbn-annual-report/

The Constitutional and legal mandate:

> Section 11, Article XVI of the 1987 Constitution provides:
> 1. The ownership and management of mass media shall be limited to citizens of the Philippines, or to corporations, cooperatives or associations, wholly-owned and managed by such citizens.
>
> The Congress shall regulate or prohibit monopolies in commercial mass media when the public interest so requires. No combinations in restraint of trade or unfair competition therein shall be allowed.[12]

Consistent with the State policy of developing an economy that is effectively controlled by Filipinos, the Constitution explicitly reserves the ownership and operation of public utilities to Philippine nationals, who are defined in the Foreign Investments Act of 1991 as Filipino citizens, or corporations or associations at least 60 percent of whose capital with voting rights belongs to Filipinos.

The above-quoted constitutional provision undoubtedly states that the ownership and management of mass media must be totally under the control of Filipinos.[13] Said requirement was reiterated by Republic Act No. (R.A.) 7042 otherwise known as Foreign Investment Act, as amended by R.A. 8179[14] and its Implementing Rules and Regulations as well as Executive Orders[15] which has, from time to time, reiterated the same in order to emphasize the mandatory requirement of full ownership of Filipinos to mass media corporations' shares.

In view of the said constitutional and legal provisions, the Securities and Exchange Commission issued SEC Memorandum Circular No. 8 Series of 2013 prescribing the guidelines on compliance with the Filipino-foreign ownership requirements prescribed in

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[12] Section 11, Article XVI of the 1987 Constitution

[13] Section 11, Article XVI of the 1987 Constitution

[14] An Act to Further Liberalize Foreign Investments, Amending for the Purpose Republic Act 7042, and for Other Purposes

[15] List A of Annex to Executive Order No. 184 Series of 2015: Promulgating the Tenth Regular Foreign Investment Negative List. The following industries are required to be wholly owned by Filipino corporations:

1. Mass Media except recording (Art. XVI, Sec.11 of the Constitution; Presidential Memorandum dated 04 May 1994)
2. Practice of all professions *1 (Art. XII, Sec.14 of the Constitution, Sec. 1 of R.A. 5181, Sec. 7. J of R.A. 8981)
   a. Pharmacy (R.A. 5921)
   b. Radiologic and x-ray technology (R.A. 7431)
   c. Criminology (R.A. 6560)
   d. Forestry (R.A. 6239)
   e. Law (Art. VIII, Section 5 of the Constitution; Rule 138, Sec. 2 of the Rules of the Court of the Philippines
3. Retail trade enterprises with paid-up capital of less than US$2,500,000 (Sec. 5 of R.A. 8762)*2
4. Cooperative (Ch. III, Art. 26 of R.A. 6938)
5. Private security agencies (SEC. 4 of R.A. 5487)
6. Small-scale mining (Sec. 3 of R.A. 5487)
7. Utilization of marine resources in archipelagic waters, territorial sea, and exclusive economic zone as well as small-scale utilization of natural resources in rivers, lakes, bays, and lagoons (Art. XII, Sec. 2 of the Constitution)
8. Ownership, operation and management of cockpits (Sec. 5 of P.D. 449)
9. Manufacture, repair, stockpiling and/or distribution of nuclear weapons (Art. II, Sec. 8 of the Constitution)*3
10. Manufacture, repair, stockpiling and/or distribution of biological, chemical and radiological weapons and anti-personal mines (various treaties to which the Philippines is a signatory and conventions supported by the Philippines)*3
11. Manufacture of firecrackers and other pyrotechnic devices (Sec. 5 of R.A. 7183)

the Constitution and/ or existing laws by corporations engaged in nationalized and partly nationalized activities. Section 2 thereof provides:

> Sec. 2 – All covered corporations shall, at all times, observe the constitutional or statutory ownership requirement. For purposes of determining compliance therewith, the required percentage of Filipino Ownership shall be applied to BOTH (a) the total number of outstanding shares of stock entitled to vote in the election of directors; AND (b) the total number of outstanding shares of stock, whether or not entitled to vote in the election of directors.

The advent of said memorandum circular inevitably requires that mass media corporations must comply with the one-hundred percent Filipino ownership not only through its outstanding shares of stock entitled to vote in the election of directors but also the total number of outstanding shares of stock, whether or not entitled to vote.

Corollary, the Foreign Investments Act's implementing rules explain that for stocks to be deemed owned and held by Philippine citizens or Philippine nationals, mere legal title is not enough to meet the required Filipino equity. Full beneficial ownership of the stocks, coupled with appropriate voting rights is essential.[16]

On this score, the Implementing Rules and Regulations of the Securities Regulation Code defines beneficial owner or beneficial ownership as any person who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise, has or shares voting power, which includes the power to vote or direct the voting of such security, and/ or investment returns or power, which also includes the power to dispose of, or direct the disposition of such security.[17]

In defining full beneficial ownership, the Implementing Rules and Regulations of FIA itself requires that mere legal title is not enough to meet the required Filipino equity, which means that it is not sufficient that a share is registered in the name of a Filipino citizen or national, i.e. he shall also have full beneficial ownership of the share. If the voting right of a share held in the name of a Filipino citizen or national is assigned or transferred to an alien, that share is not be counted in the determination of the required Filipino equity.[18]

In the same vein, if the dividends and other fruits and accessions of the share do not accrue to a Filipino citizen or national, then that share is also to be excluded or not counted.[19] Thus, if a "specific stock" is owned by a Filipino in the books of the corporation, but the stock's voting power or disposing power belongs to a foreigner, then that "specific stock" will not be deemed as "beneficially owned" by a Filipino.[20]

Therefore, what is required is not merely legal title but full beneficial ownership over the shares of stock, having the right to all the benefits accruing to the stockholder by virtue of the shares, i.e. dividends, which, if said shares underlies a PDR, said full beneficial

[16] *Gamboa vs. Teves*, G.R. No. 176579, October 9, 2012

[17] *Roy vs. Herbosa*, G.R. No. 207246, November 22, 2016

[18] *Id.*

[19] *Id.*

[20] *Id.*

ownership will be absent to the stockholder, considering that the holder of the PDR and not the stockholder will have the right to obtain the benefits accruing to the shares of stock regardless of lack of ownership over the same.

Foreign control in mass media corporations:

It is beyond cavil that there is a need to acknowledge existence of numerous corporate control-enhancing mechanisms, besides ownership of voting rights, that limits the proportion between the separate and distinct concepts of economic right to the cash flow of the corporation and the right to corporate control.[21]

Control is the power to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities.[22] Ownership of voting shares or power alone without economic control of the company does not necessarily equate to corporate control. A shareholder's agreement can effectively clip the voting power of a shareholder holding voting shares. In the same way, a voting right ceiling, which is "a restriction prohibiting shareholders to vote above a certain threshold irrespective of the number of voting shares they hold," can limit the control that may be exerted by a person who owns voting stocks but who does not have a substantial economic interest over the company.[23] So also does the use of financial derivatives with attached conditions to ensure the acquisition of corporate control separately from the ownership of voting shares, or the use of supermajority provisions in the bylaws and articles of incorporation or association.[24]

Indeed, there are innumerable ways and means, both explicit and implicit, by which the control of a corporation can be attained and retained even with very limited voting shares, i.e.., there are a number of ways by which control can be disproportionately increased compared to ownership so long as economic rights over the majority of the assets and equity of the corporation are maintained.[25]

Therefore, it is a corporate reality that control can exist regardless of ownership of voting shares. And to allow the issuance of PDRs by mass media corporations to foreigners subjects the mass media industry to foreign control, regardless of ownership of its shares, in utmost disregard of the intent of the constitution.

Foreigners can greatly control and influence corporate decision-making processes even if they do not have legal title to the shares. Non-stockholders or persons or entities that do not have shares of a subject corporation registered under their names can remain in effective control, albeit indirectly, of those with controlling interest by just having specific property rights ("use and title") in equity given to them while the legal title of the property given to another.[26]

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[21] Concurring Opinion: Velasco, Jr., J, Roy vs. Herbosa, G.R. No. 207246, November 22, 2016, citing Gamboa vs. Teves, G.R. No. 176579, October 9, 2012 citing SRC Rule 3(E) of the Amended Implementing Rules and Regulations (IRR) of the SRC and Sec. 3(g) of The Real Estate Investment Trust Act (REIT) of 2009

[22] *Id.*

[23] *Id.*

[24] *Id.*

[25] *Id.*

[26] Dissenting opinion: Mendoza, J., Roy vs. Herbosa, G.R. No. 207246, November 22, 2016 citing Black's Law Dictionary (2nd Pocket ed. 2001 p. 508).