RECENT DEVELOPMENTS

INTERNATIONAL

SUPREME COURT OF THE PHILIPPINES UPHOLDS VALIDITY OF MINING ACT AND FTAAS (GR NO. 127882)*

On 2 December 2004, the Supreme Court of the Philippines (the Court) gave its ruling in relation to a motion for reconsideration of a decision of the Court on 27 January 2004 in *La Bugal – B'laan Tribal Association, et al v Secretary Ramos, et al*. In its recent decision, the Court has held that:

- the *Philippine Mining Act* (Republic Act No. 7942) ('the Mining Act') and its Implementing Rules and Regulations are constitutional;
- foreign owned companies are permitted to enter into Financial and Technical Assistance Agreements ('FTAAs');
- FTAAs may involve more than simply financial or technical assistance; and
- foreign owned companies are permitted to acquire a beneficial interest in mining activities in the Philippines (although beneficial ownership of natural resources remains with the State).

The Court's decision reverses its January 2004 decision and resolves the uncertainty that has existed in relation to FTAAs and foreign owned mining enterprises in the Philippines since the commencement of these proceedings in 1997.

Background

On 27 January 2004, the Court had held that certain provisions of the Mining Act, its Implementing Rules and Regulations, and the FTAA dated 30 March 1995 between the Philippines Government and Western Mining Corporation (Philippines) Inc (WMCP) ('the WMCP FTAA'), were unconstitutional.[1] Following that decision, motions for reconsideration were filed with the Court. This note summarises the Court's decision in respect of these motions.

Issues addressed

The following significant issues were addressed by the Court in its recent decision:

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1 The Court held that FTAAs were akin to service contracts and that such contracts were prohibited under the 1987 Philippines Constitution because they 'allowed foreign control over the exploitation of [Filipino] natural resources': see (2004) 23 ARELJ 1.

(a) Whether the questions in the case had been rendered moot by the sale in January 2001 by Western Mining Corporation ('WMC') of all its shares in WMCP to Sagittarius Mines, Inc (a Filipino corporation owned 60 per cent by Filipinos and 40 per cent by Indophil Resources N.L) ('Sagittarius') and by the subsequent transfer and registration of the WMCP FTAA from WMCP to Sagittarius.

(b) The meaning of the phrase 'agreements involving either technical or financial assistance' in paragraph 4, section 2 of Article XII of the Philippines Constitution (the Constitution).

(c) Whether certain provisions of the Mining Act, its Implementing Rules and Regulations and the WMCP FTAA breached paragraph 4, section 2 of Article XII of the Philippines Constitution (the Constitution).

Paragraph 4, section 2 of Article XII

The Court referred to paragraph 4, section 2 of Article XII of the Constitution as follows:

> The State may undertake exploration, development and utilisation ('EDU') activities through either of the following:
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> (a) By itself directly and solely;
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> (b) By (i) co-production; (ii) joint venture; or (iii) production sharing agreements with Filipino citizens or corporations, at least 60 per cent of the capital of which is owned by such citizens…
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> For large scale EDU of minerals, petroleum and other mineral oils, the President may enter into agreements with foreign owned corporations involving either technical or financial assistance according to the general terms and conditions provided by law.

Whether the questions in the case had been rendered moot

The Court held that, even if the case was moot, the 'strong reasons of public policy' (i.e. the uncertainty hanging over the mining industry, as well as the constitutionality of the Mining Act and its Implementing Rules and Regulations) gave it jurisdiction to hear the matter. The Court also held that if the WMCP FTAA had originally been issued to a Filipino owned company, no issue of constitutionality would have arisen.

The petitioners argued that the sale of shares in WMCP to Sagittarius was invalid because paragraph 4, section 2 of Article XII of the Constitution only allows FTAAs to be entered into by the government with foreign corporations, not corporations with 60 per cent (or more) Filipino ownership. The Court held that such an interpretation was not supported by the text of the Constitution, and even if it were, such an interpretation 'would apply only to the transfer of the FTAA to Sagittarius, but definitely not to the sale of WMC's equity stake in WMCP to Sagittarius'. Otherwise, an 'unreasonable curtailment of property rights without due process of law would ensue'.

Further, the Court rejected the contention that the transfer of WMCP shares to Sagittarius was a 'transfer in equity' of the FTAA (which would require the President's prior approval under section

40 of the Mining Act) because section 40 does not apply to a transfer of shares in a company. However, the Court emphasised that in this case the transfer was to a Filipino company. It left open the question of whether the President's prior approval is required for a transfer of shares (in a company that is party to an FTAA) to another foreign company.

Meaning of 'technical or financial assistance'

The Court rejected the argument that it is only those agreements with foreign owned corporations for EDU activities which involve technical or financial assistance that are permitted by the Constitution. On this point, the Court's reasoning was as follows:

(a) The use of the word *involving* 'signifies the possibility of the inclusion of other forms of assistance';

(b) FTAAs are akin to service contracts;

(c) The mere fact the term 'service agreements' is excluded from the 1987 Constitution does not establish that its drafters intended to exclude foreigners from the management of mining enterprises;

(d) A literal interpretation of Article XII lends itself to an illogical result. That is, since financial and technical assistance would be of advantage to the mining industry as a whole, 'there would be no need to limit [agreements with foreign owned corporations] to large-scale mining operations' if in fact only financial or technical assistance was permitted;

(e) The framers of the Constitution were aware of issues of commercial pragmatism and, in particular, that companies would not provide assistance 'without requiring arrangements for the protection of their investments, gains and benefits'. The drafters impliedly assented to any conditions that these agreements would require in order to be commercially viable, including 'management authority with respect to the day to day operation of the enterprise and measures for protection of the interests of the foreign corporation, provided that Philippine sovereignty over the enterprise undertaking the EDU activities remains firmly with the State'; and

(f) If service contracts were intended to be prohibited, the drafters of the 1987 Constitution would have provided for the termination of existing service contracts.

The Court also looked to the intent of the drafters of the Constitution to elicit the true meaning of Article XII. In doing so, the Court considered that discussions of the framers demonstrated that they were in fact referring to service agreements and they knew agreements with foreign companies 'were going to entail not merely technical or financial assistance but, rather, foreign investment in and managing of an enterprise involved in large-scale exploration, development and utilisation of minerals, petroleum and other mineral oils'.

The Court confirmed that 'the Constitution allows for the continued use of service contracts with foreign corporations – as contractors who would invest in and operate and manage extractive enterprises, subject to the full control and supervision of the State'.

Permitted extent of control by foreign companies

According to the Court, there was no inconsistency in the Constitution between paragraph 1 section 2 of Article XII, which requires the State to exercise full control and supervision over the EDU of natural resources, and paragraph 4 which allows service contracts with foreign parties. In addition, the Court observed that 'the government does not have to micro-manage the mining operations and dip its hands into the day to day affairs of the enterprise'. Such a requirement would 'discourage foreign entry into large scale exploration'.

Constitutionality of Mining Act and Implementing Rules and Regulations

On this point, the Court held that the relevant provisions of the Mining Act (and its Implementing Rules and Regulations) were constitutionally valid and did not enable FTAAs to grant full control of mining activities to a foreign company such that the State would become a passive regulator. This is evidenced by the fact that:

> [T]he government agencies concerned are empowered to approve or disapprove – hence to influence, direct and change – the various work programs and the corresponding minimum expenditure commitments … [T]he FTAA contractor is not free to do whatever it pleases and get away with it; on the contrary, it will have to follow the government line if it wants to stay in the enterprise …

Validity of WMCP FTAA

In general, the Court confirmed that the WMCP FTAA was valid and upheld the right of shareholders of a contractor to freely transfer, dispose of or encumber their shareholdings.

However, section 7.9 of the WMCP FTAA was held invalid (but severable from the rest of the WMCP FTAA) because it had the effect of depriving the Government of its entire 60 per cent share in net mining revenue (which it was entitled to under section 7.7 of the WMCP FTAA) without any form of compensation in exchange.[2] Section 7.9 therefore constituted an unjust enrichment to the benefit of the local and foreign shareholders of WMCP and violated public policy.

The Court also declared section 7.8(e)[3] invalid (but severable from the rest of the WMCP FTAA) because it allowed sums spent by the government for the benefit of the contractor to be deductible from the State's share of net mining revenues. Similarly, in the Court's view, this constituted an 'unjust enrichment … at the expense of the Government'.

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2 Under clause 7.9, if foreign shareholders of WMCP sell 60% or more of their equity to a Filipino citizen or corporation, the State loses its right to receive its share of net mining revenues under s 7.7.

3 Under s 7.8(e), the government share of net mining revenues is deemed to include 'an amount equivalent to whatever benefits that may be extended in the future by the Government to the Contractor or to financial or technical assistance agreement contractors in general'.

Financial benefits for foreigners

In relation to the potential for foreigners to benefit financially from FTAAs, the Court observed that '[t]he Constitution has never prohibited foreign corporations from acquiring and enjoying beneficial interests in the development of Philippines' natural resources'. In addition, it recognised that where the Government undertakes EDU activities in tandem with companies with at least 60 per cent Filipino ownership 'the 40 per cent individual and/or corporate non-Filipino stakeholders obviously participate in the beneficial interest derived from the development and utilisation of … [the] natural resources'.

Importantly, the Court confirmed that the foreign component 'may have a say in the decisions of the board of directors, since they are entitled to representation therein to the extent of their equity participation' (which under the Constitution is up to 40 per cent).

Conclusion

The recent reconsideration by the Supreme Court of its decision in *La Bugal – B'laan Tribal Association, et al v Secretary Ramos, et al* has confirmed the legal validity of the basis for foreign companies to own 100 per cent of mining projects in the Philippines under an FTAA. In doing so, the strength with which the Court delivered its judgement has also allayed significant concerns that had arisen for foreign investors in the oil and gas and cement sectors (see AMPLA Journal Volume 23, Number 1, April 2004), as well as the heightened negative perception of Philippines sovereign risk that arose from the Court's original decision. The recent decision, together with an increase in support for the mining industry from the re-elected President Macapagal-Arroyo, and coinciding with increased commodity prices and buoyant capital markets, has revitalised activity in the Philippines mining sector to a level not seen since the passage of the new Mining Act in 1994.

COMMONWEALTH

STRENGTHENING OFFSHORE MARITIME SECURITY IN RELATION TO AUSTRALIA'S OFFSHORE OIL AND GAS FACILITIES[*]

On 15 December 2004, the Prime Minister announced initiatives, to be implemented progressively through 2005, that build on previously announced maritime security initiatives, and focus in particular on the protection of Australia's offshore oil and gas facilities, and on ensuring that any terrorist to Australia's maritime assets can be quickly detected.

- The Australian Defence Force will take responsibility for offshore counter-terrorism prevention, interdiction and response capabilities and activities, including the protection of offshore oil and gas facilities and offshore interdiction of ships. Responsibility for civil

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