THE NEW PHILIPPINE MINERAL REGIME: AN OPPORTUNITY FOR INVESTMENT?

BY

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<tr>
<td>AO</td>
<td>Administrative Order</td>
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<tr>
<td>DENR</td>
<td>Department of Environment and Natural Resources</td>
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<tr>
<td>DOL</td>
<td>Declaration of Location</td>
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<tr>
<td>EO</td>
<td>Executive Order</td>
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<tr>
<td>FSE</td>
<td>Far South East Gold Resources Inc</td>
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<tr>
<td>FTAA</td>
<td>Financial or Technical Assistance Agreement</td>
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<tr>
<td>MPSA</td>
<td>Mineral Production Sharing Agreement</td>
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<tr>
<td>PD</td>
<td>Presidential Decree</td>
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<td>SEC</td>
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THE NEW PHILIPPINE MINERAL REGIME:
AN OPPORTUNITY FOR INVESTMENT?

I. INTRODUCTION

A ring of fire encircles the Pacific Basin, an unstable region of earthquakes, faulting and intense volcanic activity. It stretches from the tip of South America, up through the Andes, across the Aleutians, down through Japan and the Philippines to the tip of New Zealand.

To the countries in the region, this geological volatility is both a misfortune and a blessing. It was a misfortune, indeed, to the local people who lived around the slopes of the Mt. Pinatubo volcano in the Philippines when it erupted in 1991. Their homes and farms were buried under metres of volcanic ash and it will be many years before they can return to the area to live. Yet when viewed from a broader perspective this geological instability has been a real boon to the Philippines, not merely because of the substantial export industry it has generated in souvenirs made out of volcanic ash, but because it is this same instability which has made the region fertile and resource rich. Over millions of years the tremendous pressures from within the earth have forced hot, mineral rich fluids up through faults created by earthquakes and faulting in the sub-surface rock. In that rock the minerals have cooled and concentrated to become mineral deposits, lying hidden underground until erosion reveals their presence to the human eye. Many of the world's major mineral deposits have been discovered in this region, such as the spectacular Hishikari deposit in Southern Japan, Erstberg in Indonesia and Bougainville in Papua New Guinea.

The impact that this mineral endowment has had on the economic development of some of the countries in the region has been enormous. In PNG, for example, minerals make up more than 80% of the country's export
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income\(^1\) and generate revenue of over Aus$350 Million per annum.\(^2\) In Australia, they make up around 40% of export income, generating revenue of around Aus$30 Billion per annum.\(^3\) The significance of such revenue flows, particularly to developing countries, can not be underestimated.

However a country's high geological potential will remain just that, unrealised potential, unless the country has access to sufficient funds to explore for new mineral deposits and to develop them when they are found. Few developing countries have sufficient domestic capital available to fund mineral development and for this reason many countries have in recent years been competing to attract foreign investment to assist in the development of their mineral industries. Vietnam, Laos, India, Peru, Argentina, Chile and others have all been taking steps to promote foreign investment by removing impediments to foreign investment, reducing government take and offering investment incentives. At the same time, Australian mining companies have been increasingly looking overseas for investment opportunities. Australian mining companies, in particular, have been seeking to place a greater percentage of their exploration/development budgets offshore in order to minimise their exposure to Australian sovereign risk, engendered by Australian Government decisions such as Coronation Hill, world heritage listings and more recently the Mabo legislation.

In such a climate, one would be tempted to speculate that the Philippine mining industry would currently be undergoing a sustained boom period. The Philippine Islands have shared the region's history of intense past volcanic

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\(^3\) Australian Bureau of Agricultural and Resource Economics, *Australian Commodities* (June 1994).
activity and appear likewise to share in its rich mineral endowment. Geologically the islands are regarded as highly prospective.\(^4\) The country has other benefits as well. It is English speaking, has a familiar western style business culture and laws, a large pool of technically qualified experts and a long history of mining. It has also not been extensively explored by modern exploration techniques, unlike the more traditional mining jurisdictions such as Australia.

Yet, rather than experiencing a boom period, the Philippine mining industry has been described as 'hanging by a thread'.\(^5\) As Joel Muyco, the current Director of Mines of the Philippines, has stated, the Philippine mining industry is currently suffering from a 'continuing trend of decreasing volume of mineral production by current operations and lack of investor interest, both foreign and local'.\(^6\)

The decline in production is dramatically illustrated in a recent Philippine Board of Investment Report\(^7\) which found that the Philippine mining sector's contribution to export revenues fell from 21.3% in 1980 to 6.56% in 1990, or in dollar terms, from US$1.2 Billion to US$0.36 Billion. Out of 28 mining companies running major mining operations in the Philippines in the early 1970's only 6 have remained active and in production today.\(^8\)


\(^8\) Joel Muyco, 'Insights on the Philippine Mining Industry' (September 1993) 1:1 Chamber of Mines of the Philippines Newsletter 9.
Although the local sector relies heavily on foreign investment for capitalisation, foreign investment in the Philippine mining industry has been almost nonexistent in recent years. Again, statistics demonstrate the decline: total paid up capital in the Philippine mining industry in 1990 was US$16 million compared with the annual average of US$22.1 million for the 1980's. Foreign equity investments in the same period fell from 4.3% to 3.9%.

One reason often cited locally to explain this deterioration is the worldwide slump in mineral prices. Yet this deterioration has not been experienced by a number of other countries in the region. PNG for example has nearly doubled its mineral production in the last five years and Indonesia also has had high minerals growth, largely as a consequence of projects generated and funded by foreign investment. No similar investment has been occurring in the Philippines. As Director Muyco bemoaned:

The other southeast Asian countries are far ahead of us. We've been left behind.

Overwhelmingly the major complaint raised by both government and investors alike is that the country's old mining laws have not provided an effective tool for the management of the country's mineral resources and in particular, that they failed to establish an attractive regime which would encourage the investment of private capital, domestic or foreign.

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9 Muyco, above n 6.
12 Michael Wood, 'Mining Industry on "Point of Collapse", Officials Lament' (February 1993) 5:3 South-East Asia Mining Letter 1.
In 1986, the opportunity for change arrived when the Philippines' 'people power' revolution overturned the rule of President Marcos and promulgated a new Constitution. That Constitution mandated a change away from a leasehold based system of mineral titles to a contractual system and since that time the Philippines Government has been working towards setting up modern workable mineral regime which the government hopes will help revitalise the Philippines' domestic mining industry and attract foreign investment.\textsuperscript{14} Representatives of the Philippine Government have been undertaking investment missions and delivering papers at numerous international conferences promoting foreign investment in the minerals industry. In response to these promotional activities and buoyed up by the recent upturn in commodity prices many of the major Australian mining companies are now reviewing the potential for investment in the Philippine industry. Yet, as these companies are starting to discover, reviewing the parameters for mineral investment in the Philippines is far from a straightforward process. The current regime is a mishmash of old laws partially repealed, new laws not yet enacted and conflicting policy initiatives. There has been little written about the regime which could help a prospective investor critically evaluate it. An understanding of the historical and cultural environment within which the laws operate is also of considerable importance in judging the future operation of the mineral regime and this understanding is not easily gained from outside of the country.

The purpose of this paper is to examine the current mineral regime and to assess whether the mineral investment package now being offered to foreign investors is a substantial improvement upon that offered under the previous regime. If it is, then the Philippine mining industry would appear to be an exiting new prospect for Australian companies eager to reduce their exposure to Australia and explore a new greenfields territory.

\textsuperscript{14} Micheline Millar, 'Mining Code May Face Rough Sailing in the House', \textit{Business World (Manilla)}, 10 September 1993.
II. THE PHILIPPINE LEGAL SYSTEM

Before commencing an analysis of the Philippine mining laws it is appropriate to briefly review the Philippine legal system within which they operate.

The Philippine legal system has been influenced by a variety of sources. Indigenous law, the laws of Spain, America, England and Indonesia have all played a part in its development. Today's legal system is primarily an amalgam of the elements of three systems, namely; Roman law, Common law and Mohammedan law.

Although the Spanish occupied the Philippines for three centuries until 1898, because the Philippine civil laws, corporations laws and other key commercial laws were drafted this century, those laws have been highly influenced by those in force in America. For this reason, the Philippine legal system is quite similar to Australia's. Civil law emanates principally from legislation rather than the common law and, in particular, the Civil Code\textsuperscript{15} sets out the law on property and the law on obligations and contracts. Nevertheless, many of the principles upon which the code is based are in line with common law principles applicable in the US and Australia.

By virtue of Article 8 of the Civil Code, judicial decisions do form a part of the legal system. However, \textit{stare decisis} is not recognised in the same sense as in common law jurisdictions. Only decisions of the Supreme Court establish precedent and are binding on the lower courts. Past Supreme Court decisions are persuasive in current Supreme Court proceedings but less so than in common law jurisdictions. Philippine judges are free to refer to the decisions of foreign tribunals, especially if the case involves law borrowed from foreign jurisdictions, such as the mining laws and the corporations code.

\textsuperscript{15} Civil Code of the Philippines 1949 (Phil) (Republic Act 388).
The rules relating to interpretation of laws under the Philippine legal system are essentially similar to those used in the Australian legal system. In particular:

(a) when the law and its meaning are clear and unmistakable, there is no need to interpret the law any further.

(b) when construction or interpretation is necessary, the court should interpret the law according to the meaning the legislature intended to give it.\(^{16}\)

The importance of the court discovering and applying the real intent and purposes of the legislature is emphasised more strongly than is the tendency under the Australian legal system. Permissible extrinsic aids for determining legislative intent include the construction given by the executive department, which is regarded as being deserving of great weight.\(^{17}\) This is important, because, in the absence of a large body of judicial precedent, often the only guidance available on the interpretation of an issue will be the determinations issued by authorities such as the Securities and Exchange Commission and the Secretary of Justice. Those opinions will be referred to as authority in this paper. Opinions of text writers or government officials can also have considerable influence on a court if those individuals are well respected.\(^{18}\)

The Philippine legal system recognises a distinction between public law and private law, with the law on property and the law on obligations and contracts belonging to the domain of private law and administrative and constitutional law belonging to the domain of the public law. Nevertheless, as a general rule

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\(^{17}\) Suarez, above n 16, 21.

when the Philippine Government enters into a contract with a private individual, its rights and duties under that contract are governed by the law applicable between private individuals.\textsuperscript{19}

\textsuperscript{19} Agipito Cobacha and Domingo Lucenario, \textit{Law on Public Bidding and Government Contracts} (1961) 286.
III. THE CONFLICT BETWEEN HOST COUNTRY AND INVESTOR OBJECTIVES

The Philippine Government was faced with a difficult task when setting up its new mineral development regime. The policy decisions reflected in the legislation will be critical to the future economic development of the Philippines. The high start up costs and long project life of minerals projects mean that failure to formulate a comprehensive and well balanced minerals management policy and carry it through in legislation which promotes, rather than undermines, the policy objectives can be particularly harmful to the mineral sector.

In setting up a mineral development regime a government is motivated by a variety of factors. The first is usually the desire to see its mineral resources developed to produce the maximum public benefits possible. In particular, it will wish to maximise the direct financial benefits to the state, including royalties from the sale of the minerals, taxes on the profit of the mining company, taxes on the wages of the company's employees, government fees and charges and transport levies.

There are also significant indirect benefits. Employment is one benefit, although the mining industry is not as labour intensive as, for example, the manufacturing industry. Development is another significant benefit; because mineral development usually occurs in remote areas the development of a mine usually involves substantial local development including the provision of transport, education, health facilities and the stimulation of the local goods and services sector. Overall, Ritchie\textsuperscript{20} estimates that the economic output multiplier for the mineral sector in Australia is that for each dollar of mineral sales (whether domestic or export), an economy-wide output of $1.70 is generated. For each dollar invested in the minerals industry a further $1 of

\textsuperscript{20} Douglas Ritchie, 'Investment Criteria for International Exploration/Mining Companies in the Asia/Pacific Region' (1990) Pacific Economic Cooperation Conference Papers 159, 162.
non-minerals sector capital investment is generated. Another benefit is that as the bulk of mineral production is exported it can be a valuable foreign exchange earner for the country.

Yet despite these potential benefits, the minerals sector competes for funds with other sectors of the economy which may be regarded as more pressing. In many developing countries the provision of food, education, medical facilities and other basic necessities must take priority for public funds over investment in mineral exploration and development. As a result, few developing countries have the internal resources necessary to develop their minerals sectors from their own funds.

Borrowing the moneys to develop the minerals sector has been one option used by a number of countries in the past to help develop the sector. However, after a decade during which international loans were easily available, many developing countries have found themselves saddled with intolerably large debt burdens which now constitute a major drain on national earnings. As a result, many developing countries, including the Philippines, have a strong aversion to further debt accumulation. In fact, even without a debt aversion, the availability of financing to developing countries is drying up and recent estimates suggest that around two-thirds of the investment for developing countries' mineral sectors will have to come from foreign, mainly private, sources. Borrowing to finance domestic development of the industry has another disadvantage in that it also does not provide the same advantages for transferring managerial resources, including production technology, management and sales know-how. Further, with loan financing the outflow of funds offshore is not linked to the success of the project as it


is with foreign equity investment.\textsuperscript{23} For all of these reasons most countries reach the conclusion that financing for minerals exploration and development primarily needs to come from private direct investment, both domestic and foreign.

Yet, notwithstanding these economic realities, competing against the need for foreign investment to fund development is the reality that, as Wallace notes,\textsuperscript{24} most developing countries have a deep distrust of multi-nationals. This distrust is a legacy of many years of colonialism and old style concession agreements which for many years conferred unequal benefits upon foreign investors to the detriment of the host country. This has left countries with a strong nationalist reluctance to permit foreigners to participate in domestic industries, particularly those relating to the exploitation of natural resources. Accordingly, alongside the state's desire to maximise its return on utilisation of its mineral resources, is its desire to have control over their exploitation, both in its capacity as owner and in its capacity as regulator.

So, in essence, the governments of developing countries are driven by the objectives of development and nationalism, both of which push to some extent in opposite directions. Not surprisingly, therefore, the countries often have a quite ambivalent attitude towards foreign investment, well summed up by the complaint that 'the only thing worse than having multi-national companies is not having them'.\textsuperscript{25} This ambivalent attitude is not infrequently reflected in ambivalent minerals legislation which appears to favour foreign investment with one provision and then undercut it with unattractive restrictions in another.


\textsuperscript{25} Wallace, above n 24.
In addition to balancing these competing objectives of development and nationalism, if the host country elects to promote development and foreign investment it must also work out a suitable balance between the needs of the country and the private investor. The imperatives which drive the private investor are quite different from those which drive the government. The private investor's principal goal is profit. The private investor is keenly aware that the mineral industry is a high risk business with many unique characteristics and that the potential for attractive profits to be gained from a successful mineral development is partnered by significant potential downside. The investor is driven by the realities of mining development which are:

- Exploration is an extremely high risk activity. The chances of making a commercial discovery have been suggested to be in the region of 1 in 1,000; or put another way, it has been estimated that on average around $83 Million needs to be spent in order to make one base metal economic discovery in Australia.\(^26\)

- Development of a mine is an extremely high risk activity. A mineral resource is defined by drilling holes in the mineralisation and extrapolating from the assays of those holes the likely grade, extent and cost of excavating and treating the minerals. Accordingly, the deposit when actually excavated can prove to be substantially different from expectations.

- The mining industry competes in international markets where the bulk of ore mineral production is exported. Mineral prices fluctuate severely over the life of a project, so that the anticipated sale price of the mineral product at the time that exploration for the mineral commences

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may bear little resemblance to its price at the time the feasibility study is prepared, and it will be different again by the time production commences and after ten years operation.

• Exploration and mining require high capital expenditure and a great deal of it must be spent years prior to the project generating any cash flow in return. Exploration is expensive as it is frequently conducted with expensive technological equipment and in remote areas with little or no existing infrastructure. Likewise the costs of setting up a mine and infrastructure are capital intensive, often requiring up front capital expenditure of hundreds of millions of dollars for a single mining project.

• Mineral exploration and mine development are long term activities. Mining projects commonly running for twenty years or more.  

Most of the foregoing considerations amount to one thing - risk, that is, the risk of incurring significant capital expenditure without return. For these reasons private minerals investors are overwhelmingly concerned about minimising and quantifying risk wherever possible. In particular, private investors are extremely sensitive to issues which have the potential to change the bottom line of a project in between the time when the investment decision is made and the time when the investor has recovered its investment and minimum required rate of return. Investors who engage in exploration need to be confident that if they make that 1 in 1,000 discovery they can develop it and recover, not only their costs spent directly upon that prospect, but all of the money spent on all the unsuccessful prospects beforehand and those which will follow in the future. Accordingly, profitability, security of title, stability of the resource management regime and confidence that there will be no undue government interference in the management of their investment are

27 See generally Ritchie, above n 20.
extremely sensitive issues to investors and will be scrutinised closely by investors considering investment in a new mineral regime.

As a result the imperatives of the country and the private investor conflict, with the developing country's objectives being generally political, relating to development and nationalism, and the private investors objectives being largely commercial, relating to profit and cost. Sovereignty and security of tenure in particular are on opposite sides of the scale. To retain national control and ownership the country will want to confer as few legal rights on the foreign company as possible. In order to be confident of recovering its investment and profit the company will prefer to acquire a direct title to the investment property and as much immunity from government interference as possible. How the mineral resources regime balances the country's imperatives against those of the private investor determines how much foreign investment the regime will attract.

The way this balance changes from time to time across the industry is demonstrated by the changes in the nature of mineral titles this century. Up until the 1950s and 1960s foreign investment in mineral development usually took place under the authority of a concession agreement. The traditional concession agreement was a mineral title under which a private investor was granted direct ownership rights over a mineral property for a long period, with 99 years not being particularly unusual. Generally the investor would be entitled to exercise exclusive management of the operations, including the right to determine the nature of the development, the volume of production, cut off grades, processing and conditions of sale. Government control and interference was excluded and the project was excepted from the laws of general application. The government return was usually in the form of a royalty, often based on a fixed amount per ton of mineral extracted. The value of the mineral extracted and the profits made by the investor were therefore largely irrelevant to the return to the government. The balance
between state rights and investor rights was weighted fairly in favour of the investor. The rationale was that, having contributed all of the capital, the investor was entitled to own the investment and receive all of the profit.  

With the gaining of independence after the Second World War, the 1950s and 1960s saw many newly independent countries begin asserting their rights of national sovereignty and demanding complete economic self determination. Concession agreements came in for close scrutiny as they were regarded as preventing the government's control of the development of a key sector of the economy and subjecting the sovereignty of the state to foreign interests. A large number of host countries insisted on the 'renegotiation' or 'restructuring' of these agreements to provide for state participation in the management of the projects. Accordingly, there was a move away from concession agreements towards joint venture type agreements in which the host government or a domestic entity was required to take a share in the equity of the project. Under these agreements the duration of the agreement was commonly reduced to 25 to 35 years and 'fade-out' clauses were introduced which required the foreign investor to divest its equity in the project according to a fixed schedule. The domestic host government or entity was liable to fund its share of the cost of exploration and development, although commonly it was 'free carried' by the private investor through the exploration and development stages, with its share of the costs being initially paid on its behalf by the investor and repayable from future production, if any.

These joint venture arrangements in turn gave rise to various types of non-equity arrangements, such as service contracts, production-sharing contracts and management contracts. Under these arrangements the state retained ownership and control of mineral development and the investor was deemed to be providing mineral development services to the state. The investor

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accordingly did not obtain any form of equity or ownership interest in the mineral property itself. The percentage of foreign participation in the project was usually limited and often subject to reduction over time. The government take was increased and often levied on a net rather than gross basis, and in some instances the investor was even limited to a specified return, with the government taking the balance of all profits from the venture. As many of the benefits from mining as possible were required to be retained within the country, including employment, provision of goods and services and processing. The balance between state rights and investor rights was weighted fairly heavily in favour of the state.

A typical example of what is commonly understood as a service contract is provided by the 1966 Agreement between the National Iranian Oil Company, the French State Agency \(^{29}\), and its subsidiary \(^{30}\). In that Agreement the Agency agreed to provide the risk capital for exploration and its subsidiary agreed to provide the technical know-how and services. The Agency and its subsidiary were described as 'contractors', and words of direct grant were avoided. The oil produced belonged to the National Oil Company, but the Agreement guaranteed that a percentage of the oil produced would be sold to the Agency at an agreed price and funds advanced by the Agency for exploration and development were to be repaid after the oil was produced in commercial quantities. \(^{31}\)

These types of agreements were principally developed for use in the petroleum industry where high profits and intense investor competition had become the norm, but they were also adapted for use in the hard rock

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\(^{29}\) Enterprise de Recherches et d'Activites Petrolieres.

\(^{30}\) Societe Francais de Petroles d'Iran.

\(^{31}\) See, further, David Smith and Louis Wells *Negotiating Third World Mineral Agreements: Promises as Prologue* (1975) 47.
minerals industry, notwithstanding the different economics and lesser investor competition in that industry.

The difficulty with these forms of title was that whether they were called 'service contracts', 'management contracts' or 'production sharing contracts', the reality was that in most circumstances the mining companies were still required to spend their own risk money on exploration and development. As Waelde notes:

The predominant mode of bureaucratic action was to view the resource agreement as what it pretended to be - a contractual service rendered by the 'contractor' on behalf of the commissioning client rather than was the substance of the operation envisaged - an equity-risk investment undertaken by an investor under conditions imposed by and negotiated with the owner of the resource; taking the pretension seriously, government agencies acted as if they were clients spending their own risk money and resource companies had to accept such interference and the formalities of the service contract pretension in order to protect some core decision making ... bureaucracy was considered to prevail legitimately over business judgment. Government geologists were supposed to be entitled to direct company-paid exploration and government agencies were supposed to have legitimacy and technical competence for the final say over development and operations.32

Agreements whereby the investor is expected to provide all of the expertise, bear all of the risk and all of the cost of minerals development but without effective control over the development and in return for a substantially reduced proportion of the rewards would not seem to be a commercially sensible proposition and this would seem to be supported by subsequent events.

In the 1980s and 1990s the pendulum has been swinging back in favour of liberalisation of restrictions on foreign investment in mineral development. Partly this has been due to the world wide economic downturn. Partly this has

been influenced by the move of foreign investment away from developing countries and particularly those countries with an unstable investment regime and restrictive foreign investment policies. Partly, also, this is because it has become apparent over time that actual control does not automatically flow from majority ownership. Most observers agree that notwithstanding the apparently significant changes in the nature of the mineral titles over the last 40 years, the extent of control exercised by investors has not in reality changed substantially from the control exercised under concession agreements. The reality is that effective control can only be exercised by a country if the country has sufficient capacity for control. Most particularly, the country must have access to high quality domestic executives with the necessary technical and managerial skills to participate in the running of mineral projects. These sorts of individuals tend to exist in sufficient numbers only in countries with mature minerals industries. These individuals also need to have access to an accepted set of national resource development policies and guidelines to guide them in their exercise of their powers. In most developing countries such policies and guidelines are less than comprehensive.

Notwithstanding the move back towards liberalisation of foreign investment restrictions, there have not been substantial changes to the types of investment agreements offered to foreign investors. Because ownership and control have become important political symbols in many developing countries, the new contractual forms allow greater freedom in allocating ownership, control and financial risks and benefits in a way that satisfy both the economic objectives and the country's political objectives. By allocating ownership to the host country, the presence of the foreign investor can be made politically acceptable while a substantial amount of control of investment and security

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34 See, eg, Asante, above n 28, 58.
may remain with the private investor. Government participation is now generally aimed less at actual majority participation in management and more towards regulation and consultation to ensure that its developmental and physical objectives are achieved. Greatly increased emphasis has been placed upon increased flexibility, particularly of fiscal terms of development contracts. Local benefit plans are now widely required to be included as part of the feasibility study for new projects and timetables for training and employment of domestic personnel are widely established.  

The Philippines itself is motivated by similar desires and objectives and suffers from similar pressures to other developing countries. The Philippines has suffered a long period of foreign occupation and exploitation, commencing with the Spanish in the sixteenth century and then the Americans, followed by the Japanese and then the Americans again until 1946. Not surprisingly many Filipinos have a deep distrust for foreign political and commercial interests. However, these nationalist sentiments have had a long term negative effect on the economy of the Philippines. Throughout the period of self rule the Filipino industrialists and landed elite have vigorously opposed foreign competition and have used nationalism to justify the protection of elite-owned enterprises. In the 1960's, when neighbouring asian countries were labouring to create more competitive, open, export oriented economies, the Philippines followed the Spanish/American pattern where 'an unholy alliance of the traditional landed class, an inefficient and protected industrial right and a pseudo-nationalistic left have combined to protect and subsidise a relatively uncompetitive and monopolistic economy'. High tariffs, subsidies and restrictions on foreign investment, far from benefitting the majority of Filipinos,

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have resulted in an ailing economy and a highly unequal distribution of wealth. Despite the countries rich resources, the majority of Filipinos today live in poverty.\textsuperscript{37}

Accordingly, the Philippines is keenly interested in developing its mining sector in order to achieve economic growth, employment and regional development.\textsuperscript{38} Yet funding this development is highly problematic. Even the local Philippine Chamber of Mines itself acknowledges that there is simply not sufficient domestic capital available to sustain a thriving industry\textsuperscript{39} and debt financing is not available, with the country having been hit by a debt crisis. For this reason, in conjunction with a recognition that it must liberalise and open up its economy generally, the Philippines has come to the conclusion that it must endeavour to attract foreign investment into its mining industry.

The effect which these competing motivations of nationalism and economics have had on official Filipino policies towards foreign investment has been described as follows:-

Nationalism, of course, has its legitimate aspirations, and, in the Philippines, will continue, as it does now, to wield much influence in the making of policy and even perhaps in the rendering of judicial decisions on foreign corporations. The just as strong, rival desire for faster economic development, however, leads to conflicting policies of encouragement to foreign investment and enterprise and policies of hostility. The task of reconciling these competing impulses is often difficult ... It would be to its own benefit, if the Philippines, apart from reasons of constitutional restraints

\textsuperscript{37} See, generally, John Bresnan, \textit{Crises in the Philippines - The Marcos Era and Beyond} (1986); Romeo Bautista, \textit{Impediments to Trade Liberalisation in the Philippines} (1988).

\textsuperscript{38} See, generally, House Passes Two Bills To Save Mining, \textit{Manila Standard} (Manila), 3 December 1993, 5; Board of Investments, above n 7, 2.

\textsuperscript{39} Toti Reyes, 'Mining Industry Facing Extinction' (September 1993) 1:1 \textit{Chamber of Mines of the Philippines Newsletter 8}.  

THE CONFLICT BETWEEN HOST COUNTRY AND INVESTOR OBJECTIVES

which must be observed, adopted a more judicious position towards foreign corporations, unburdened by any unwanted 'sentimental provincialism'.

To appreciate the width of views on the subject of foreign investment and the effect this has had on the establishment of the country's minerals policy, it is revealing to look at some of the statements made in the constitutional convention proceedings on the issue. In the 1935 proceedings, for example, Delegate Enrique Mortilla expressed his views regarding the importance of Filipino ownership and control of the country's natural resources:

Lands and natural resources are immoveable and as such can be compared to the vital organs of a person's body, the lack of possession of which may cause instant death or the shortening of life. If we do not completely nationalise these two of our most important belongings, I am afraid that the time will come when we shall be sorry for the time we were born. Our independence will be just a mockery, for what kind of independence are we going to have if a part of our country is not in our hands but in those of foreigners...

In the 1986 constitutional debates, Commissioner Davide again argued against foreign ownership and control of the country's natural resources, stating that:

No alien must be allowed to enjoy, exploit and develop our natural resources. As a matter of fact, that principle proceeds from the fact that our natural resources are gifts from God to the Filipino people and it would be a breach of that special blessing from God if we will allow aliens to exploit our natural resources...

Fifty years from now, if we will allow these aliens to exploit our natural resources, there will be no more natural resources for the next generations of Filipinos. It may last long if we will begin now. Since 1935 the aliens have been allowed to enjoy to


41 Quoted in Narciso Pena, Philippine Law on Natural Resources (1973) 3.
a certain extent the exploitation of our natural resources, and we became victims of foreign dominance and control. The aliens are interested in coming to the Philippines because they would like to enjoy the bounty of nature exclusively intended for the Filipinos by God.\footnote{Philippines, Proceedings of the 1986 Constitutional Convention, 359.}

Commissioner Villegas, Chairman of the Committee on the National Economy and Patrimony, responded to Commissioner Davide's comments as follows:-

This matter of ownership has been fully discussed in the Committee with all the public hearings possible and the conclusion that the 60-percent Filipino ownership is a sufficient guarantee that the national welfare is going to be preserved. Secondly, when we talk about shortage of domestic capital, this is most acute in the exploration and development of natural resources because it is in these activities that there is a very high risk, especially in oil exploration. It would prejudice not only the people who are not going to be employed by these types of corporations that will not be able to attract the necessary capital, but it would also prevent the utilisation of natural resources for the present generation in order to help them develop their talents and skills through education and other development programs.\footnote{Philippines, above n 42, 359.}

Commissioner Villegas criticised that Filipino pre-occupation with foreign domination. He emphasised:-

It is very clear that we need foreign investment. There is no question about that and that is the stand of the Committee. It is a supplement to domestic savings. Now, to go beyond that motherhood statement, domestic savings today in the Philippines are in the worst state we have ever had in our postwar history. During the last 20 years, we could invest 30 percent of our national income or what is called 'GNP'. Out of that 30 percent, only 25 percent was raised by Filipinos; the 5 percent had to be borrowed and that is why we went on a borrowing spree. Does the body know what is the state of investment now in the Philippines, after the devastation wrought by the last regime? Instead of 30 percent we can invest only 15 to 18 percent, and out of

\footnotetext[42]{Philippines, Proceedings of the 1986 Constitutional Convention, 359.}
\footnotetext[43]{Philippines, above n 42, 359.}
that, most of it has to be literally squeezed from the domestic sources because as we very well know, our international credit standing is very bad. That is why it is very clear that for many years to come we will need foreign capital to supplement domestic savings in order to help the millions and millions of Filipino people who are unemployed, underemployed and those who are below the poverty line. So when we say we need foreign capital, it is not to fatten the pockets of the rich. It is to provide opportunities for the millions of people who are looking for work.\(^\text{44}\)

The position Commissioner Villegas espoused on foreign participation obviously won the day, as the mineral development provisions were passed in substantially the form proposed. However, it is indicative of the depth of feeling on the issue that a vote to increase the required percentage of Filipino ownership in mineral projects from 60% to 100% was lost by only 16 votes to 22. No motions were put to decrease the 60% Filipino ownership requirement.

\(^{44}\) Philippines, above n 42, 302.
IV. DEVELOPMENT OF THE PHILIPPINES' MINERAL LAWS

A. The Mineral Laws up to 1974

The Philippine mining laws had their genesis in the sixteenth century when the Spanish colonised the islands and introduced the Regalian doctrine, which deemed all minerals to be owned by the Spanish Crown. Nevertheless, mining was not developed to any significant degree during Spanish rule.

This regime came to an end in 1898 when America won the Philippines from Spain in the American/Spanish war. One of the very early pieces of legislation enacted by the new regime was a new mining act\textsuperscript{45} which overturned the Regalian doctrine and introduced a freehold system of mineral title, with all deposits being declared 'free and open to exploration, occupation and purchase'\textsuperscript{46}. Mining rights were initiated by discovery and location, culminating in a patent which gave the holder a fee simple title to both the subject land and the minerals within it.

The words 'free and open' were perhaps an overstatement of the position, however, because applications for mining titles were restricted to citizens of the US or the Philippines. Clearly, at that time, the US Government was not overly enamoured with the free trade concept. Notwithstanding the restriction, the industry expanded significantly during this period.

In 1935, amidst overwhelming nationalist fervour, the US granted partial independence and a Constitution of the Philippines was promulgated. Specific provisions dealing with state policies on mineral development were incorporated, in particular Article VIII Section 1, which stated that:

\textsuperscript{45} The Philippine Bill 1902 (US).

\textsuperscript{46} Section 21.
all agricultural, timber and mineral lands of the public domain, waters, minerals, coal, petroleum, and other mineral oils, all forces of potential energy, and other natural resources of the Philippines belong to the State, and their disposition, exploitation, development, or utilisation shall be limited to citizens of the Philippines, or to corporations or associations at least 60 percent of the capital of which is owned by such citizens, subject to any existing right, grant, lease or concession at the time of the inauguration of the government established under this Constitution. Natural resources, with the exception of public agricultural land, shall not be alienated 47

This provision re-established Regalian doctrine and new mineral laws were passed under its authority which abolished the patent system of mineral titles in favour of a leasehold system, a system which, although amended, lasted until 1990.48

As the highlighted words show, Article VIII imposed a restriction on foreign equity and control of mineral projects by restricting the interest foreigners could hold in mineral projects to 40% (the '60/40 rule').

The 60/40 rule, however, was subject to two substantial exceptions. The first exception was that any mineral rights existing at the time of implementation of the Constitution were entitled to be perfected and exploited. A large number of these existed at the time of the implementation of the Constitution and a few still continue to this day. The second exception was that citizens and corporations of the United States were given full parity rights with Filipino citizens and therefore were entitled to continue to acquire and develop new mineral rights, right up to until 1974.

47 Article VIII s 1 (authors highlighting).
48 The Mining Act 1936 (Phil) (Commonwealth Act 137).
Due to these exceptions, there was active and continuous American involvement in the Philippine mining industry throughout post-war period. The spectacular development of the copper industry in the 1950's and 1960's, for example, was mainly the handiwork of American dominated companies such as Lepanto, Atlas and Marcopper. Throughout this period, however, pressure continued to build to expand the role of Filipinos in the mining industry. The Filipinisation of the mining industry had become an important objective with the movement for economic nationalism which had followed the formal acquisition of political independence. With the Garcia administration adopting the 'Filipino First' policy during the late 1950's, the Filipinisation movement was virtually transformed into an official national policy.

As 1974 approached, when the US parity rights were due to expire, American dominated mining firms had little option but to dilute their ownership by inviting 60% Filipino equity participation. Some companies, like Lepanto, gradually built up the Filipino share in the company's equity from the 1950's, others like Benguet waited until the early 1970's. No company was exempted from the requirement. To this day these American established companies and the operations they developed remain the backbone of the 'domestic' Filipino mining industry.49

B. The Mineral Resources Development Decree of 1974

In 1972, President Marcos declared martial law, suspended the 1935 Constitution and promulgated a new Constitution. Shortly afterwards he promulgated the Mineral Resources Development Decree of 1974 No 463 ('PD 463'), the predecessor legislation to the current regime.

Like the legislation before it, PD 463 declared that all minerals were owned by the state and made them available to private entities for the purpose of exploration and utilisation through a leasehold system of title. An applicant obtained rights to explore for or exploit minerals by filing a Declaration of Location ('DOL'), a document which described the area upon which a mineral discovery of some sort was claimed to have been made. Upon registration of the DOL the applicant obtained 'the right to occupy, explore and develop the said claim'.

To retain and perfect its title the claim owner was then required to survey the mining claim and, provided that mineralisation had been established, to apply for a mining lease within two years. A mining lease granted the lessee the right to 'remove, process and utilise the mineral deposit for his own benefit and use the lands covered by the lease for the purpose or purposes specified therein'.

In many respects, PD 463 titles were similar in nature to the traditional concession style of mineral title. The application procedure for mineral titles under PD 463 made little allowance for administrative control. Provided that the ground was not otherwise claimed and provided that the applicant for the title complied with the statutory requirements the Department was required to issue the title to it. Section 16, for example, provided that:

Upon payment of the prescribed fees and compliance with the requirements under existing rules and regulations on the matter, the declaration of location of the mining claim duly accomplished and notarised shall be registered by the mining recorder concerned.

50 Section 20.

51 Section 44.
Section 40 likewise required the Minister to issue a mining lease upon satisfaction of the statutory requirements of application and survey.

There was little avenue for the government to exercise its discretion as to whether the grant of the mineral title was in the best interests of the country or to consider issues such as whether the applicant was a genuine miner with the technical capability, financial resources or even any intention of exploring and developing the area. Similarly, little opportunity was provided for government control and input during the term of the mining claim. The claim owners’ obligations to perform work, rather than being tailored to the specific project, consisted of annual work obligations at a level prescribed by regulation. These obligations were measured in financial, rather than physical terms, with compliance being established by filing an affidavit asserting compliance and a statement of expenditure. Greater allowance for administrative input was made during the lease stage, with the leaseholder being required to file programs of work for the approval of the director of the Bureau of Mines.52

Although the 1972 Constitution repeated the 60/40 rule, it also contained a new provision specifically designed to allow foreign participation in the industry. It specifically authorised Filipino citizens to enter into 'service contracts for financial, technical, management or other forms of assistance with any foreign person or entity ... '.53

The original idea behind the service contract provision was to authorise the government, rather than private individuals, to enter into service contracts with foreign entities. This idea was based on the new breed

52 Section 37.

53 Article VIII s 9.
of service agreements previously discussed which were being adopted by a number of countries at that time including India, Pakistan and particularly Indonesia. When finally adopted by the constitutional convention, however, the provision was amended to allow private Filipinos to enter into them directly with foreign investors.

On its face, this service contract provision represented a significant departure from the 60/40 rule. Under service contracts, while ownership of the mineral titles themselves remained in the hands of Filipinos (or 60% Filipino owned companies) there was nothing in the provision which restricted the percentage of the projects net revenue which the foreign investor was entitled to take in compensation for the use of its skills, experience, and financial resources on the project. Likewise there was no restriction on the degree of control over the project which could be ceded by the domestic titleholder to the service contractor. It is not clear whether the government originally intended service contracts to be subject to the 60/40 rule or whether it simply changed its mind, but either way in October 1978 the President approved guidelines fixing the maximum service fees payable to foreign service contractors at 40% of net proceed of the mining operations. This did not entirely resolve the ambiguity as it did not clarify whether the service fee the foreign investor received under the services contract should be treated as separate and distinct from their equity dividends. The Bureau of Mines took the position that 40% of the net proceeds of the operations represented the maximum allowable pre-tax remuneration for equity dividends and service contract fees and this position was made law by Presidential Decree No 1677. 54

Although the claim and leasehold regime established by PD 463 was similar in style to many regimes around that time there were a number

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54 Lopez, above n 49, 243.
of difficulties with the regime. As previously noted, there were no mechanisms by which the government could restrict the grant of mineral rights to entities who had a genuine intent and capacity to explore and develop them. This encouraged real estating which was harmful both to the government, as its mineral resources were being unproductively 'locked up', and to genuine investors who were unable to access ground.

The regime was inflexible, arbitrary and relied excessively on provisions which deemed certain non-compliances to result in automatic cancellation of the title. Failure by some sections of the administration to enforce the abandonment provisions left a large number of claims noted on the register as valid and existing which, according to the legislation, should in theory be deemed abandoned. Again this resulted in land being locked up by parties with no genuine interest in exploration. Further, because Philippine mineral titles are not indefeasible (i.e. even after grant there is nothing which prevents their validity being challenged), it left a new title holder exposed to the risk of prior titleholders coming forward and claiming prior rights to the ground. The confusion which this caused was unattractive both to the government which was trying to administer the system and the investors trying to work within it.

The government felt that, for the reasons previously discussed, the regime did not allow it to exercise sufficient control over minerals development, particularly over projects managed under service contracts where the foreign investor had no direct relationship with the government.

The regime also provided little incentive to foreign investment. All mineral titles were required to be held by Filipinos or companies at
least 60% Filipino owned. The only way a foreign investor could explore and develop on its own behalf was under a services contract with a Filipino titleholder, which did not allow the investor to hold the title in its own name nor to exercise majority control of the project, thus exposing the foreign investor to significant security of title risks. Further, following the Presidential Decrees, the foreign investor was restricted to 40% of the profits of the venture.

As noted, it is important to keep in mind when considering the 60/40 rule that the Philippines suffers a chronic capital shortage. It does not have a healthy domestic mining industry with a large number of domestic companies willing and able to take on a 60% contributing interest in mining projects. This is particularly the case with high risk exploration projects or projects at the feasibility stage which require a large capital investment to set up a mine.

The problem which this creates has been demonstrated in an alarming manner to prospective investors on a number of occasions. A current example is provided by Far South East Gold Resources Inc, which is a joint venture company in which an Australian company, CRA Ltd, holds a 40% stockholding interest and a leading Philippine mining company, Lepanto Consolidated Mining Corp, holds a 60% stockholding interest. The venture was established five years ago to mine deep gold deposits in northern Luzon, Philippines, at a projected capital cost of US$300 Million. However, the project appears to be unable to proceed due to difficulties in raising the US$50 Million domestic component of the projects US$90 Million equity requirement. Kerry Packer's failed investment in Co-O Ridge seems to be another example.55

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55 Lawrence MacDonald, 'Philippines' Gold Mines Fail to Pan Out' *Asian Wall Street Journal* (Hong Kong), 2 September 1992.
Accordingly, the implicit expectation under PD 463 seemed to be that foreign investors would bear all of the project cost and project risk, in return for only 40% of the rewards and no control over their investment. As previously commented, this hardly seems an attractive proposition for a foreign investor. It brings to mind Rowan Callick's comments in relation to similar issues in PNG, where he remarked that the country was seeking 'extraordinarily self-sacrificial conquistadors - investors who will provide the country with massive capital and operate mines ... on its behalf, while not presuming to involve themselves further.'  

Certainly the service contracts were not successful in attracting significant foreign investment into the Philippine mining industry.

The 60/40 rule has been described by foreign investors as 'the most significant commercial disincentive to the foreign investor in the Philippines' mining industry.'

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V. THE NEW PHILIPPINE MINERAL LAWS

The foregoing describes the background and context of the current mineral regime and identifies some of the inadequacies of the previous regime which the new regime is intended to address. The purpose of this chapter is to examine the new forms of mineral title created by the 1987 Constitution and to identify how the package of rights and obligations granted to the investor has changed, with particular regard to how the balance between the government's desire for control and the investors' desire for security has shifted.

A. The Constitutional Authority for the New Laws

Following the people's power revolution of 1987 and the overthrow of President Marcos, a new Constitution of the Philippines was promulgated which, as well as making a number of democratic reforms, also moved away from the leasehold system of mineral titles and instead prescribed a contractual system of title.

Like its predecessors, Article XII, section 2 of the Constitution declares that the country's mineral resources are owned by the state and shall not be alienated. It provides that:

The exploration, development and utilisation 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 60 per centum of whose capital is owned by such citizens.

... The President may enter into agreements with foreign-owned corporations involving either technical or financial assistance for large scale exploration, development, and utilisation of minerals, petroleum, and other mineral oils...
according to the general terms and conditions provided by law, based on real contributions to the economic growth and general welfare of the country.

The country's increasing sensitivity to state control of natural resources is demonstrated by the new declaration that mineral activities are subject to 'the full control and supervision of the State'. The other major change is that the only manner in which the Constitution now authorises the state to grant private entities the right to explore or utilise these resources is by way of direct contract between the state and the entity concerned. The specific authorisation for Filipino companies to enter into service agreements with foreign companies has been removed and replaced with direct agreements with the government for technical or financial assistance.

Unfortunately the promulgation of the constitutional mandate to set up such a regime in 1987 was not promptly followed by the enactment of new mineral laws. This has left the mineral management regime in a state of confusion which has not been resolved to this day.

In 1987 the President issued Executive Order No 211 of 1987 ('EO 211') which stated that applications for PO 463 titles would continue to be accepted and processed. This order was promptly followed by Executive Order 279 of 1987 ('EO 279') which authorised the Secretary of the Department of Environment and Natural Resources ('the Department') to negotiate and conclude the agreements introduced by the new Constitution. EO 279 did not, however, specify whether EO 211 was rescinded and instead provided that all of the provisions of PD 463 which were not inconsistent with EO 279 would continue in force and effect. This left open the argument that the government could issue titles under both the PD 463 regime and the new regime introduced by the 1987 Constitution.
The constitutional validity of EO 211, in so far as it purports to authorise the continued issuing of new PD 463 titles, must be questionable. PD 463 prescribes a system for the acquisition of mineral titles by location, claim and lease. However, the constitutional authority for such a system of tenure was revoked in 1987 and replaced by constitutional provisions which authorised the state to grant mineral rights only by way of one of the forms of agreement prescribed in the Constitution. By what authority was the President then entitled to empower the Department to grant mineral rights by way of claim or lease? The Department's continued processing and perfecting of existing claims was probably justifiable under an extension of the principles laid down by the Philippines Supreme Court in *Gold Creek Mining Corp. v. Eulogio Rodriguez* 58, which held that legislation establishing a new titles system could not, without due process of law and just compensation, deprive a prior locater of their rights to perfect that title. It is difficult to see, however, by what authority the President was entitled to authorise the confering of new mineral rights by the registration of DOLs after the promulgation of the new Constitution.

Notwithstanding the foregoing, for three years after the promulgation of the new Constitution, the Department did continued to process new claims. Perhaps it was reassured by the declaration of the Philippine Supreme Court in an earlier case that:

> As a general rule, the findings of government agencies with respect to the construction of statutes, the implementation of which has been reposed in them, are controlling on the court. 59

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58 GR No L-45859 28 September 1938; 66 SCRA 259.

59 Greenhills Mining Company v Office of the President GR No L-75962, 30 June 1988.
In 1989, the Department made its first attempt to resolve the inconsistency between its policy of registering DOL's and the new constitutional provisions, by promulgating Administrative Order 104, Series of 1989 ('AO 104'). AO 104 provided that during the period that there were no rules governing the award of the new types of titles, DOLs may be registered, but only 'upon presentation of a Letter of Intent indicating the desire of the applicant to enter into a Production Sharing Agreement..'. The Order also provided that the acceptance of these applications for DOLs was subject to the condition that the same was only for 'the purpose of identifying the technical boundaries of the area of interest of the applicant subject of a Production Sharing Agreement that may be awarded..'.

This attempt to clarify the situation in fact made it more confusing, because the meaning of these provisions is extremely unclear. Exactly what rights and obligations did an applicant assume by lodging a DOL with a Letter of Intent? Administrative Order 57, Series of 1989 ('AO 57') had been issued only months before setting out the procedures for obtaining production sharing agreements and they made no reference to DOLs registered with Letters of Intent. The use of the term 'DOL' seemed to indicate an intention that registration of DOLs would continue confer PD 463 mining claims on the applicant, giving them the rights to explore the land and perfect the DOLs into mining leases. On the other hand, the proviso that the registration was only for the purpose of identifying the boundaries of the area applied for under the area of the production sharing agreement suggests that the registration of the DOL with a Letter of Intent is intended to confer only the rights of an applicant for a production sharing agreement and no more. Yet there were no provisions which required the applicant to proceed further with negotiating an application for a mineral production sharing agreement.
The Department took the first view. Until November 1990, AO 104 was relied upon by the Department to continue to register and administer DOLs as it had prior to the new Constitution being promulgated. The Department took the view that registration of such DOLs continued to create mining claims, which conferred rights to explore, possess and utilise minerals within the area claimed in the DOL. Indeed, the Department required persons who filed DOLs to pay occupation fees for the land covered by the DOLs and to file affidavits confirming that they had complied with annual work obligations in respect of the areas.

Finally, in November 1990, the Department issued Administrative Order 82, Series of 1990 ('AO 82'), which made a praiseworthy attempt to clean up the old mining claims. It required that, prior to 17 July 1991, the holders of all DOLs, exploration permits and other titles not perfected prior to the affectivity of AO 57 and the holders of all mining leases and similar agreements granted after the affectivity of the 1987 Constitution must apply for substitute production sharing agreements or else be deemed to have abandoned their claims.

A praiseworthy attempt perhaps, but also doomed. Shortly prior to 17 July 1991, the Miners Association of the Philippines applied to the Philippine Supreme Court seeking a declaration that AO 57 and AO 82 were void on the grounds that they had been issued in excess of the Department's rule making power. The Association asserted that:

* EO 211 had provided for DOLs to continue to be accepted;

* EO 279 had recognised the continued efficacy of PD 463, in so far as it is not inconsistent with EO 279;
continued acceptance of DOLs was not inconsistent with EO 279;

therefore, in so far as AO 57 and AO 82 purport to bar the registration of new DOLs and require existing claim holders to submit letters of intent they purport to repeal provisions of PD 463 which are not inconsistent with EO 279;

accordingly AO 57 and AO 82 are ultra vires, as an administrative issuance cannot amend an executive order.

In response to these arguments, the Supreme Court issued a temporary restraining order preventing the Department 'enforcing and implementing' AO 57 and AO 82 but providing that they 'may still be enforced by public respondents against mining claim holders who are not involved in the present case and who are willing to abide by the said orders'.

Accordingly, the current situation can best be described as a mess. The Department is not accepting new DOLs, but it is not dismissing old DOLs which were filed with a Letter of Intent. Nor is it requiring DOL holders to comply with their maintenance obligations under PD 463, nor to progress their Letters of Intent into production sharing agreements. Nor is it expediting the court proceedings.

The best hope of clarifying this situation is by the enactment of a new code which will replace all pre-existing legislation, decrees and orders

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60 Miners Association of the Philippines Inc v Hon Fulgencio Factoran GR No L-98332, resolutions of 2 July 1991 and 10 September 1991.
and which will clarify the status of all pre-existing titles. Unfortunately, however, this does not appear likely to occur. For some years a number of substantially similar mining bills have been tabled in the Congress and the Senate to implement the new mineral regime. House Bill 10816 is the most advanced bill, as it has now passed its second reading and it is this version which I will refer to in this paper as the 'Mining Bill'. The Mining Bill, however, is not a code and again repeals pre-existing legislation only where it is 'inconsistent with the Act'. It does little to clarify the situation regarding DOLs other than to provide that holders of valid and existing mining claims shall have preferential rights to enter into a mineral agreement for two years from commencement of the Mining Act. It does not clarify what constitutes a valid mining claim nor what happens to a claim if no application for a mineral agreement is made.

There are a large number of these DOLs noted on the Departments records and with no mechanism having been established to finally determine their validity they seem likely to present a security of title problem for subsequent applicants for the ground for many years hence. This is unlikely to be attractive to prospective investors, domestic or foreign.

B. The New Mineral Titles

The four new forms of mineral title established by the 1987 Constitution are:

(a) co-production agreements;

(b) joint venture agreements;
(c) production sharing agreements; and

(d) financial or technical assistance agreements.\(^61\)

(In this paper, I shall refer to all four agreements as 'mineral agreements' although, under the Mining Bill, financial or technical assistance agreements are excluded from this term).

The Constitution specifically lists each type of title by name, yet despite the novelty of these types of mineral title to the Philippines, the framers of the Constitution made no attempt to go further and describe what these titles were intended to be. Presumably they intended the titles to be equivalent to the titles bearing similar names which have been in use in other countries for some years. However, although the use of familiar names may give a prospective investor a temporary feeling of comfort, the comfort is unlikely to last for long when the prospective investor endeavours to clarify precisely what rights and obligations these types of titles are intended to confer. The nature of these types of titles now varies considerably between the various jurisdictions where the titles have been created and, as Smith has pointed out:

\begin{quote}
In practice the line between the conventional concession contract on the one hand and a service, work, or production sharing contract on the other has been less than distinct. And the boundaries dividing service contracts, work contracts and production sharing agreements from each other have often been very blurred indeed.\(^62\)
\end{quote}

As previously noted, the reality now is that the choice of names of mineral titles commonly reflects political considerations rather than

\(^{61}\) Article XII, s 2, quoted on page 33.

\(^{62}\) Smith, above n 31, 47.
strictly legal considerations. A contract described as a 'contract of work' or 'services agreement' can generally be presumed to be an indication of the government's desire to imply greater state control than is the tendency in concession type contracts. But these days it can be unwise to draw too much more from the names than this. With this caution, it is nevertheless the best available starting point from which to commence an examination of the new Philippine titles.

1. Mineral Production Sharing Agreements

The key title under the new regime is called a Mineral Production Sharing Agreement ('MPSA').

Production sharing contracts developed in the 1960s as a variation of service contracts. Like service contracts, under production sharing contracts the investors are described as 'contractors' and are deemed to be providing 'services' to the state and those services generally amount to providing all financial and technical assistance required for the operations. The contractor carries the risk of operating costs, including the costs of exploration and development, and is responsible for the day to day execution of the operations under the management and control of the state. Generally production sharing contracts were used in the petroleum industry, but they have sometimes been used in hard rock mineral agreements.

The key distinction between production sharing contracts and service contracts was traditionally that production sharing contracts were reserved for arrangements where the investor and the government shared in the output of the operation in
predetermined proportions, whereas under service contracts the contractor was generally remunerated on a fee basis.

An example of an early production sharing contract was the 1968 contract between an Indonesian State company P N Pertambangan Minjak Nasional ('Pertamina') and Phillips Petroleum Company ('Phillips'). Under that contract, Phillips was declared to be the contractor responsible for exploring and developing a petroleum prospect and, in return, was entitled to recover its operating costs, in the form of oil, up to an amount equal to 40% per calendar year of crude oil produced. The balance of the oil produced was divided, with 65% going to the state company and 35% being retained by Phillips. The title to Phillips portion of the oil passed to Phillips at the point of export and Phillips was required to market all of the crude oil produced if the state company so required. Title to all equipment purchased by Phillips for the project was vested in Pertamina when the equipment was landed in Indonesia.

In 1989, the Philippine Department of Environment and Natural Resources ('DENR') issued guidelines on MPSAs designed to clarify their nature and terms (the 'Guidelines'). They define an MPSA as being:

An agreement wherein the government grants the Contractor for (sic) the exclusive right to conduct mining operations within but not title over, the Contract Area and shares in the production whether in kind or in value as owner of the minerals therein. The Contractor provides all the necessary financing, technology management and personnel. 63

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63 DENR Administrative Order 57, Series of 1989 (Phil), art 3.1.
The interesting point about the above definition is that it allows the government's share to be taken 'in value', and this in fact is what has been done in every MPSA entered into to date. In each case the government 'take' has been a percentage of the gross revenue of the operation plus a percentage of the net profits. This will be formalised in the new mining laws, which provide for the 2% gross minerals excise tax to be the government share under MPSAs. In this respect the financial arrangements under MPSAs appear to have moved a fair way away from the production sharing concept and instead bear a strong resemblance to the financial arrangements under traditional style mineral contracts. Presumably this is in recognition of the fact that the agreement as proposed does not really contemplate a great deal of 'sharing' on the part of the government. It is the contractor who provides all the financing, technology management and personnel. The government's contribution is limited to its consent to the development of the minerals. The reluctance to take a share of product also may be prompted by the government's desire to rely on contractors marketing and sales expertise.

The Guidelines set out the procedures for the grant of MPSAs. They provide that in areas where the economic viability of the mineral resource has been previously established, an MPSA is awarded through bidding. In all other cases it is awarded by negotiation. In reality this often simply means the completion and approval of the proforma mineral production sharing agreement issued by the Department (Appendix A).

Unlike an applicant for a title under PD 463, an applicant for an MPSA is not entitled to the grant of title as of right. There are
no provisions requiring the government to issue a title on compliance with statutory procedures. Instead, the Guidelines require the government to award mineral agreements to parties which it deems most capable of conferring optimal benefits on the Filipino people.

The Guidelines provide for MPSAs to be granted for a maximum term of 25 years, renewable for a further 25 years. They are 'cradle to grave' agreements authorising all mining activities from exploration through to production. This feature of the new regime is likely to be quite attractive to investors because it removes the necessity for an investor to apply for a development and/or mining title if its exploration is successful. Provided that the investor complies with the terms of the MPSA, it is entitled to retain and work under the authority of the original title for 25 years. Likewise the investor can agree up front to the major terms and conditions that will apply to the project before it has spent its first exploration dollar. Both of these factors have a real impact on reducing the investor's risk.

The Guidelines in fact go beyond setting up the procedures for the granting of MPSAs and also set out in some detail the rights and obligations that contractors 'shall' have. These include exclusive possession of the contract area, subject to surface and easement rights, the right to explore, develop and extract minerals and the right to sell, assign, encumber or otherwise dispose of all of their interest under the agreement, subject to the approval of the government. They do not provide for contractors to obtain any specific rights to the minerals themselves nor any specific right to sell the minerals. This leaves open the question of whether contractors are entitled to
dispose of the minerals they produce, as Article XII of the Constitution provides that 'All ... minerals ... are owned by the State. With the exception of agricultural lands, all other natural resources shall not be alienated'. Clearly this provision would seem to represent a bar to the government conferring proprietary rights over minerals which are still in situ upon contractors. In fact, taken literally, this provision could mean that even the processed end products of mining cannot be disposed of and must be used for domestic purposes alone. This, however, would not be consistent with the contractors right to receive a share of production or revenue. The most likely future interpretations are that the minerals become the property of the contractor after excavation, transport off site or sale to a third party, but this is speculation only at this time.

Contractors are obliged to contribute to national development by helping develop host and neighbouring communities, provide local employment and training and give preference to Filipino goods and services.

Like titles under PD 463, a mineral agreement does not have the status of legislation and so it is not within the power of the executive to grant exceptions to laws of general application by the terms of the mineral agreement. For this reason, the taxation rules, which are governed by legislation of general application, cannot be waived or amended in a mineral agreement. Likewise, the mineral agreement does not confer government approvals under any legislation other than the mining laws and it is still necessary for the investor to apply separately to other government departments for various
approvals, including environmental approvals, forestry consents, water use rights and the like.

In addition to the rights set out in the Guidelines, the Senate Mining Bill also makes a number of investment guarantees to foreign investors. In particular, it guarantees:

- freedom from expropriation and requisition, subject to the usual exceptions for the national welfare.

- the right to remit both the capital investment and earnings in the currency in which the investment was originally made and at the exchange rate prevailing at the time of remittance.

- the right to remit moneys necessary to meet payments of principal and interest on loans.

- the right to export the processed minerals or mineral products.

- the right to import free of all import and export duties all supplies and equipment needed for the mining operations where they are not available on equivalent terms or equivalent quality in the Philippines.  

The protections from expropriation and requisition are mirrored in the Constitution itself. The level of security provided to the investor is accordingly reasonably good. The need to obtain

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64 Senate Bill No 1639 (Phil), s 99.
other approvals introduces an element of uncertainty but the requirement is common to many jurisdictions. Direct government expropriation or requisition is prohibited except in closely defined circumstances. The main concern of the private investor relating to title security is likely to be the extent of the government's control powers.

As noted, there has been considerable Filipino debate upon the importance of state ownership and control over minerals development and the Constitution makes all such development subject to the full control and supervision of the state. Further, the government has deliberately chosen to name this title with a name which characterises the title as one where the investor is not a principal, nor even a partner in the development, but is merely a contractor providing mineral development services to the government. Accordingly, an investor is likely to expect to see fairly onerous government supervision and control provisions incorporated into the legislation.

There has been little change to the mechanisms for control and supervision from the position under PD 463 in respect of leases. Control is principally exercised through the requirement that the contractor submit work programs and have them approved by the government prior to work being undertaken. Supervision is principally effected by requiring the contractor to report on its activities on a regular basis. A review committee has also been established to review and evaluate the performance of each contractor but no specific mechanisms have been established for its findings to be acted upon. No provision has been made for a detailed involvement by the government in the day to day running of the project.
This is not to suggest that this level of supervision and control is inadequate. On the contrary, it is entirely consistent with the level of supervision exercised by the governments in many countries. Certainly the mechanisms do permit the government to exercise as much supervision and control over the activities as it considers appropriate on a case by case basis. Nevertheless, it does not provide for the level of 'hands on' involvement in the day to day running of the project or the generation of development proposals which the name of the title might otherwise have suggested the government would wish to have. The governments role is more that of a regulator than a participant, setting policy parameters within which the project will operate, scrutinising proposals put to it by the contractor and penalising non compliance, rather than participating directly in the development of proposals. It would appear from this that, like many other countries, the government has concluded that on a day to day level mining activities are better managed by mining companies than by bureaucrats and that bigger issues can be effectively controlled through the work program and feasibility study approval process. This appears to support the impression, already gained, that the government in moving to the new contractual style of title may have been motivated more by the essentially political objective of being seen to be increasing state control over minerals development, than a need for a new control and supervision structure.

Probably the biggest disincentive to foreign investment in an MPSA is that, as previously noted, MPSAs are subject to the 60/40 rule, that is, they may only be obtained by Filipino citizens or entities at least 60% Filipino owned and controlled. Accordingly, the only way that a foreign investor can obtain an
interest in an MPSA is via an incorporated joint venture with a Filipino partner who owns 60% of the shares in the project company. The precise mechanics of this relationship are discussed further in chapter 6.

2. **Financial or Technical Assistance Agreements**

Financial or Technical Assistance Agreements ('FTAAs') are the title created by the 1987 Constitution specifically for foreign investment in minerals. Like MPSAs, their nature is not specifically defined in the Constitution, which merely states:

> The President may enter into agreements with foreign-owned corporations involving either technical or financial assistance for large scale exploration, development, and utilisation of minerals.  

It is apparent from this provision, nevertheless, that they are contemplated as a form of 'assistance' for 'large scale' projects. The words 'large scale' in this context have been defined as meaning:-

> those proposals for contracts or agreements for mineral resources, exploration, development, and utilisation involving a committed capital investment in a single mining unit project of at least fifty million dollars in United States currency (US$50,000,000.00).  

What is clear from the wording of the Constitution, is that the FTAA is intended to be a contract directly between the

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65 Article XII, s 2.

66 Executive Order 279 of 1987 (Phil), s 4. No such definition appears in the Mining Bill.
government and the foreign investor, in contrast with the situation under PD 463 where the service contract was between the foreign company and the domestic company, and where it was the domestic company which owned and controlled the mineral title. As such, that direct contracting relationship potentially represents a significant improvement in the tenure and control of foreign investors, who can now deal directly with the government and who can obtain the mineral title in their own sole name. They are no longer restricted to a minority shareholding in a 60/40 project company and/or the position of a technical manager delivering services to such a company.

Yet although the creation of a 100% foreign owned mineral title is a substantial improvement on the old regime, it is wise to recall that the FTAA is described as an "agreement" to provide "assistance" for the development of minerals, rather than a mineral "lease", "licence" or other more traditional style of mineral title. This choice of name is suggestive of a desire to limit the amount of control which can be exercised by foreign investors over mineral projects governed by FTAA and avoid any suggestion of foreign "ownership" of mineral resources. This impression is supported by a reading of the constitutional convention proceedings, which reveal the extent of the delegates' concern to restrict the terms of foreign participation under FTAA. For example, in the proceedings on the 13 August 1986, Commissioner Quesada queried:

The 1973 Constitution used the words 'service contracts.' In this particular Section 3, is there a safeguard against the possible control of foreign interests if the Filipinos go into co-production with them?
Commissioner Villegas, Chairman of the Constitutional Convention Committee on the National Economy and Patrimony, replied:

Yes. In fact, the deletion of the phrase 'service contracts' was our first attempt to avoid some of the abuses in the past regime in the use of service contracts to go around the 60-40 arrangement. The safeguard that has been introduced - and this, of course, can be refined - is found in Section 3, lines 25 to 30, where Congress will have to concur with the President on any agreement entered into between a foreign-owned corporation and the government involving technical or financial assistance for large-scale exploration, development and utilisation of natural resources.\(^\text{67}\)

Commissioner Quesada later expressed her :-

fear that foreign investors will use their enormous capital resources to facilitate the actual exploitation or exploration, development and effective disposition of our natural resources to the detriment of Filipino investors. I am not saying that we should not consider borrowing money from foreign sources. What I refer to is that foreign interest should be allowed to participate only to the extent that they lend us money and give us technical assistance with the appropriate government permit. In this way, we can ensure the enjoyment of our natural resources by our own people.\(^\text{68}\)

Commissioner Villegas, re-emphasised the nature of FTAAs, replying:-

Actually, the second provision about the President does not permit foreign investors to participate. It is only technical or financial

\(^{67}\) Above n 42, 278.

\(^{68}\) Above n 42, 316.
assistance - they do not own anything - but on conditions that have to be determined by law with the concurrence of Congress. So, it is very restrictive.

If the Commissioner will remember, this removes the possibility for service contracts, which we said yesterday were avenues used in the previous regime to go around the 60-40 requirement. 

Yet despite the foregoing statements, under the Guidelines and the Mining Bill the nature of FTAAAs does not appear to be substantially different from the nature of MPSAs. The government has placed considerable emphasis upon the fact that FTAA contractors do not obtain any proprietary rights over the mineral property and this specific highlighting of the position of FTAA contractors in particular has sometimes led to the implication that contractors under the other forms of agreement did obtain such rights. This is clearly not the case, however. None of the mineral agreements under the new regime confer proprietary rights over land or minerals. This is implicit in the nature of the titles, which, as previously discussed, are agreements where the investor is deemed to be working as a contractor, providing services for the government rather than participating as an equity holder or partner. In relation to MPSAs this is also specifically stated by AO 57 which confirms that an MPSA 'grants the Contractor the exclusive right to conduct mining operations within but not title over, the Contract Area'.

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69 Above n 42, 317.

70 Article 3.1.
Likewise, although it will not become apparent for some time how closely in fact the government will supervise and seek to participate in the management of operations under FTAs, it is interesting to note that the legislation and the first FTA issued to date adopt the same system of work programs and reporting as applies to MPSAs.

Although these similarities are surprising when viewed in the context of what the government has said about FTAs, the reality is that the issues of ownership and control are both dealt with in the Constitution and the restrictions which apply to FTAs apply equally to MPSAs. In both cases the Constitution makes it clear that all minerals are inalienably owned by the state and that their exploration, development and utilisation is under the full control of the state. The Constitution imposes no special restrictions on FTAs.

One potentially significant difference between FTAs and MPSAs is that the Mining Bill imposes an extremely long list of obligations and warranties upon contractors under FTAs which do not apply to contractors under MPSAs, so long in fact that the authors appear to have run out of space in which to confer any specific rights upon FTA contractors. However, most of those provisions are essentially reasonable and will apply to mineral activities in most developing countries. They are, therefore, unlikely to cause foreign investors overly much concern.

In fact, the major difference between FTAs and MPSAs, putting aside the preconditions to their grant, is their revenue sharing provisions and divestment requirements. As previously noted,
the government share under an MPSA is only 2% of gross revenue (plus taxes). However, AO 63 specifies that the government share under an FTAA is 60% of the project's net revenue, with the remaining 40% going to the contractor.\(^71\) AO 63 also provides that after 10 years from recovery of its pre-operating expenses the foreign contractor must divest at least 60% of its equity in the project to Filipinos.\(^72\) Both of these requirements have been reproduced in the first FTAA signed.

It is apparent from the foregoing that, notwithstanding that the Constitution states that FTAAAs can be issued to foreign investors, the government, or at least its executive arm, still considers FTAAAs to be bound by the 60/40 rule, at least as far as revenue sharing is concerned. This view has been formalised in the form of an Opinion from the Secretary of Justice, to the Director of the Mines and Geosciences Bureau. The Opinion emphasises that all FTAAAs should contain a term specifying that the foreign contractor shall at all times be under the full control and supervision of the government and concludes that:

Likewise, any production sharing scheme in such agreement should always be along the letter and spirit of the 60/40 Filipino-foreign equity contribution requirement under the Constitution for the exploration, development and utilisation of natural resources.\(^73\)

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\(^71\) Section 13.

\(^72\) Section 14.

\(^73\) Opinion 175, Series of 1990.
The Opinion gives no further explanation for the proposition that the revenue generated under FTAs is subject to the 60/40 rule, nor does it quote any authority in support.

It appears likely that the Secretary of Justice, in issuing his opinion that FTAs are subject to the 60/40 rule, relied on the fact that FTAs had been introduced in substitution for the service contracts available under PD 463. Accordingly, he appears to have reasoned, because those service contracts were bound by the 60/40 rule, so too should FTAs be bound by the rule.

In reaching this conclusion, however, it would appear that the Secretary of Justice has not fully considered the changes in the law effected by the 1987 Constitution. Service contracts under PD 463 were held to fall within the requirements of 60/40 rule because the 1972 Constitution specifically stated that:

> The disposition, exploration, development, exploitation, or utilisation of any of the natural resources of the Philippines shall be limited to citizens of the Philippines, or to corporations or association at least sixty per centum of the capital of which is owned by such citizens. The Batasang Pambansa, in the national interest, may allow such citizens, corporations, or associations to enter into service contracts for financial, technical, management, or other forms of assistance with any foreign person or entity for the exploration, development, exploitation, or utilisation of any of the natural resources.\(^74\)

That section made it quite clear that all exploration and development of natural resources was subject to the 60/40 rule. The new Constitution phrases the 60/40 rule differently. It

\(^{74}\) Article XIV, s 9.
imposes the 60/40 restriction, not on mineral activities, but rather on the types of entities which can enter into co-production, joint venture and production sharing agreements. It deals separately with FTAA:

The exploration, development and utilisation 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 60 per centum of whose capital is owned by such citizens.

... The President may enter into agreements with foreign-owned corporations involving either technical or financial assistance for large scale exploration, development, and utilisation of minerals, petroleum, and other mineral oils according to the general terms and conditions provided by law, based on real contributions to the economic growth and general welfare of the country. 75

Unlike the part of the Article relating to MPSAs, the part relating to FTAA makes no reference whatsoever to the 60/40 rule.

This view has been confirmed by ex-Commissioner Villegas in a letter of 6 September 1993 to the Director of the Mines and Geosciences Bureau commenting on the intentions of the Constitutional Committee on the National Economy and Patrimony which drafted the provision. In that letter he stated that:

The 60/40 requirement exclusively refers to the ownership structure of corporations or associations with which the state may enter into co-production, joint venture, or production sharing agreements.

75 Article XII, s 2.
does not refer to the manner in which the revenue should be shared between the contractor and the government. The 60/40 requirement was meant to guarantee Filipino control of the exploration, development and utilisation of natural resources.

Thus, the revenue sharing between the government and the contractor can be subject to other ratios that may be deemed necessary to attract the huge capital needed by these large scale exploration projects. I can conceive of the situation in which the government agrees to receive only 10% of the total revenues and the contractor 90%, if that is what can attract the investors to assume the high risks inherent to the exploration, development and utilisation of natural resources.

What the forgoing demonstrates is that the principal concern of those drafting the constitution was about entrenching protections for Filipino control and ownership of natural resources, issues based to a large extent on concerns about national sovereignty, rather than revenue sharing. It is apparent that the framers were critical of the effectiveness of the PD 463 system of 60/40 companies and service contracts, which they appear to have felt had not provided the government with adequate control over the activities of foreign companies. Instead, the framers decided to use a different mechanism for achieving their objectives, that is by introducing a direct contracting relationship between the foreign investor and the government under a contractual, "assistance" form of mineral title.

Unfortunately for foreign investors, to date the Secretary of Justice opinion stands and AO 63 imposes a 60/40 rule on revenue sharing and a requirement of divestment after 10 years from recovery of pre-operating expenses. The Mining Bill does little to clarify the issue, as it neither imposes these
requirements, nor revokes them. Final resolution of the issue must therefore presumably await the regulations which will be enacted when the Mining Law is passed, replacing AO 63.

Notwithstanding the government's stance on these issues, when it is determining the manner in which the revenue shares are calculated, the government has made a number of concessions which improve the return to the contractor.

Firstly, the contractor is not required to commence paying the government share until the contractor has recovered its pre-operating expenses. Accordingly, profits generated in the first few years of a new project can be applied directly by the contractor to recoup its capital outlay on the project. This reduces project risk, makes financing easier, and reduces the project payback period, all factors of significance to investors considering whether to commit to a new development. Taxes, including the minerals excise tax, are not, however, similarly deferred. This first recovery right would have been available to contractors under service contracts under the prior regime, so this concession is unlikely to be regarded as a significant improvement on the old regime.

The second concession is that when the project starts to generate a return and the government share does become payable, that share is deemed to include all government taxes and charges, including corporate income tax (35%), minerals excise tax (2%) and withholding tax (15%). Payments to indigenous land holders or surface rights holders are also deemed part of the government share. In fact, all forms of remuneration to Filipino entities can probably be offset against
the 60% government share, because the rationale for imposition of the 60% figure appears not to be that this is the minimum return that the government is prepared to accept, but rather that the 60/40 rule requires that no more than 40% of the net revenue generated by the project should go into the pocket of the foreign contractor. The government is guaranteed its the basic return, i.e. the 2% minerals excise tax (which is payable on all minerals produced) and its corporate and various other taxes, as these are payable under separate legislation and cannot be varied by the FTAA.

This concession would certainly seem to go some part of the way towards making the FTAA a more attractive form of title to foreign investors than the service contracts under the previous regime. Nevertheless, it still results in foreign contractors paying a considerably higher government share than domestic contractors who are only liable for taxes (including the 2% minerals excise tax).

The potential of the FTAAs would, therefore, seem to be limited for so long as the government insists on discriminating against foreign investors by restricting foreign investors return to 40% or less of the net revenue of the project and requiring divestment of 60% of the investors equity after 10 years. Under these conditions the FTAA is not an enormous advance on the service contracts allowed under the old regime.
3. **Co-Production and Joint Venture Agreements**

The two other agreements introduced by the 1987 Constitution are Co-Production and Joint Venture Agreements. The Mining Bill defines them in the following manner:

Co-Production Agreement is a mining agreement between the government and the contractor wherein the government shall provide inputs to the mining operations other than the mineral resource.

Joint Venture Agreement is an agreement where a joint venture company is organised by the government and the contractor with both parties having equity shares. Aside from earnings in equity, the government shall be entitled to a share in the gross output.

In each case it is envisaged that the government will be required to contribute something more than just the right to exploit the minerals. This is perhaps the reason why the government has not assigned a high priority to the promulgation of implementing guidelines in respect of these agreements.

C. **The Stability and Responsiveness of the New Mineral Titles**

As previously noted, security of investment is one of the key investment criteria of foreign investors. Security of title has previously been mentioned, that is the guarantees that when a discovery is made the investor will be able to obtain and / or retain the rights to develop that resource. Stability of the legal, fiscal and political conditions which will govern the investment is an equally important part of the equation. Investors will naturally be concerned to obtain some reassurance that the conditions upon which they base their financial projections before
committing themselves to an investment will remain reasonably stable throughout the term of the investment.

One issue which can potentially have a significant impact upon the stability of the investment conditions is the question of whether the mineral title is contractual or administrative in nature. Conceptually at least, the new mineral regime appears to have significantly changed the legal character of Philippine mineral titles with the replacement of claims and leases by mineral agreements. The question remains, however, whether the change in name of the titles has been accompanied by a significant change in their nature and if so, to what extent is this change likely to impact upon the stability of the titles?

1. The Statutory/Contractual Classification

Mineral titles can essentially be classified into categories: they can be administrative/statutory in nature or they can be contractual in nature.

Although terminology varies widely across mineral regimes, administrative titles are commonly bear names such as 'permits', 'licences', 'leases' or 'authorisations'. Contractual titles are generally referred to as 'agreements' or 'contracts'.

Administrative type titles are essentially statutory creations. Legislation authorises the grant of an administrative title and details the procedure which must be followed for the creation of a valid mineral title. The legislation also generally specifies in detail the rights and obligations conferred by that title upon the titleholder and the State. This package of rights and obligations is fairly standard across all titles granted under the regime. By
their nature administrative titles are essentially unilateral in character.

In creating administrative titles the state is acting in its capacity as legislator, setting rights and obligations of general application to all parties coming within the statutory regime. The rights and obligations conferred on a titleholder are created and imposed on the titleholder by operation of law. The investor's role is reduced to that of an applicant and the relationship between the investor and the government is consensual only in the sense that the investor has a choice regarding whether to submit itself to the legislative regime by applying for the title or not. There is, however, little consensual element in respect of the creation of the rights and obligations, and those rights and obligations tend to have a strong public law character, being created pursuant to the government's obligations to protect the public interest.

In contrast, the legislature has little role in the creation of contractual titles. Under contractual titles the parties rights and obligations and the terms under which the development proceeds are created by negotiation between the government and the investor and are promulgated by agreement between them. The rights and obligations are truly consensual in nature. In creating such titles the state is acting primarily in its capacity as owner of the resource, selling certain of its rights in respect of the minerals which it owns. Legislation will commonly provide the statutory authority, preconditions and procedures for the state's property in the minerals to be dealt with but it will not commonly detail the contents of the contract. This enables the parties to set up a management regime appropriate to the specific needs of each project.
The administrative regime has a number of drawbacks which has seen a shift in recent years towards the contractual approach. One major drawback is that, as previously mentioned, such regimes tend to be fairly rigid. Mining operations vary dramatically. They may be located in environmentally sensitive areas, deserts or salt lakes, far from infrastructure or near to urban development. They may include extensive processing facilities or none at all. They may provide large scale employment and local development or they may be small scale, short life operations. They may be extremely attractive to prospective investors or they may be of borderline interest to investors, with low revenues, high initial capital costs or extreme sensitivity to commodity price fluctuations or costs. Administrative regimes rarely have the flexibility to take all of these types of factors into account and adapt themselves to each individual mining operation. This tends to mean that with extremely profitable operations the government does not receive the maximum benefits which the operation is capable of generating and on the other end of the scale some borderline mineral resources are not developed, resulting in a loss by the government of potential revenue, employment or infrastructure.

Another drawback with administrative regimes is that government input into the development process traditionally tends to be unduly focused on the decisions to grant/renew rather than ongoing monitoring and negotiation. The administrative regime also tends to foster an adversary relationship between the government and the investor, as the 'take it or leave it' basis on which rights and obligations are prescribed by statute leads to a high reliance upon legal interpretation of those provisions to resolve issues. Contractual
regimes on the other hand emphasise the consensual and mutually beneficial nature of the relationship between the parties and therefore tend to encourage the parties to resolve issues through negotiation, co-operation and mutual problem solving. This has the downside of increased delay, uncertainty and exposure to political imperatives, but the advantage of generally improved end results.\(^\text{76}\)

2. *The Nature of Philippine Mineral Titles*

There is little doubt that the titles available under the 1987 Constitution are truly contractual in nature. They are called 'agreements', their terms are set by a true process of negotiation and they incorporate a number of provisions which demonstrate an intention that the title should be subject to the principles of private contractual law; for example, force majeure clauses, provision for termination by either party for breach of the agreement and arbitration.

Yet, notwithstanding this characterisation, the titles do contain some administrative characteristics. AO 57 sets out in reasonable detail some of the rights and obligations which should attach to MPSAs. A number of these obligations are designed to advance the public interest, such as the environmental protection provisions and local development and training. A number are designed to enable the government to exercise its regulatory functions to control and supervise the activities in order to protect the public interest. These obligations are required in all contracts and are, therefore, not

truly consensual. Yet they are imposed by the operation of the contract rather than by operation of law, as AO 57 gives effect to them by requiring them to be included as conditions of the contract rather than making them part of the general law.

Accordingly, the agreements are probably best characterised as essentially contractual in nature, with some administrative features.

The legal characterisation of mining leases created under PD 463 is less clear. The actual lease documentation issued by the government took the form of a contract, in that it commenced with recitals and was signed by representatives of the government and the lessee. Section 41 of PD 463 also permitted the lessee to apply for cancellation of the lease contract due to force majeure, a provision more commonly associated with the performance of contractual obligations, than the performance of statutory obligations.

Yet aside from these indications suggesting that the mining leases are of a contractual nature, a closer examination of PD 463 suggests that the leases are in many respects more statutory in nature. The application procedure, for example. PD 463 required an application for a lease to be made by the filing of an application form and the Minister was required to 'issue' or 'grant' the lease to the applicant. This language can be contrasted with the language used in relation to service

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77 Section 36.

78 Section 40.

79 Section 44.
contracts in section 44 of PD 463, which are described as being 'entered into' rather than 'issued' or 'granted'. There is no provision for the applicant to negotiate 'the terms of the lease document, which were almost completely standard, set by the government. Financial obligations and most of the terms and conditions governing the leases were expressed to be in accordance with general law, as amended from time to time. A contractual characterisation also sits uneasily in a context where the Minister was required by legislation to grant the title if the largely procedural requirements of PD 463 were met.

The reality is, as these titles demonstrate, that despite fairly clear distinctions on a theoretical level between administrative and contractual titles, the distinction is rarely as clear on a practical level when endeavouring to assess particular mineral titles established by specific mineral regimes. This is because contractual regimes usually retain significant administrative elements and many administrative titles have contractual elements.

On the basis of the foregoing, it appears that there has been a change in the nature of mineral titles, from mining lease contracts, which, although they took the form of contracts, were essentially administrative in nature, to mining agreements which are contractual both in form and nature.
3. *Stability and Responsiveness*

(a) *Resistance to Unilateral Variation*

Probably the greatest significance of the distinction between a contractual title and an administrative title is the extent of protection which that title gives to the titleholder against changes to the terms of the title by unilateral state action. The terms of an administrative title, being created and governed by the provisions of legislation, can be varied by the simple measure of enacting amending legislation. Provided that the variation is not so extreme as to breach the constitutional prohibition on the expropriation of property without due process and compensation, the state has the right to unilaterally vary the terms of the title by the enactment of amending legislation. As noted, this was the position in relation to PD 463 mining leases where the financial obligations and most of the conditions governing the leases were expressed to be in accordance with general law, as amended from time to time.

This position can be contrasted with the relatively secure position of contractual titles under Philippine law. Under a contractual title, the parties' respective rights and liabilities and the fiscal and administrative regime which will apply throughout the project are determined by agreement between the parties. By reason of the principle of *pacta sunt servanda* (or sanctity of contract) they can reasonably expect the regime established by that agreement to apply throughout the term of the contract.

This principle has been codified by the provisions of the Civil Code, which provide:-
Obligations arising from contracts have the force of law between the contracting parties and should be complied with in good faith.  

These provisions apply not only to contracts between private entities, but also to contracts between the government and private entities, as under Philippine law when the government enters into a contract its rights and duties therein are generally governed by this law applicable to contracts between private individuals. As noted by the Philippine Supreme Court:

if, where and when the state or its government enters into a contract, through its officers or agents, in furtherance of a legislative aim and purpose and pursuant to constitutional legislative authority, whereby mutual or reciprocal benefits accrue and rights and obligations arise therefrom, and if the law granting the authority to enter into such contract does not provide for or name the officer against whom action may be brought in the event of a breach thereof, the state itself may be sued even without its consent, because by entering into a contract the sovereign state has descended to the level of the citizen and its consent to be sued is implied from the very act of entering into such contract.

Notwithstanding the above, the difficulty with applying the principle of *pacta sunt servanda* to agreements between investors and host countries is that it cuts across the principle of legislative sovereignty which decrees that neither the executive nor the legislature can bind future exercises of legislative power.

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80 Article 1159, see also art 1356.


82 *Santos v Santos* (1952) 92 Phil 281, 283 (Padilla J).
Is it possible to prevent the terms agreed in a contract from being amended by or superseded by subsequent legislation?

There has been considerable debate in many jurisdictions regarding which principle has precedence. In the Philippines, however, the Constitution itself has elevated the principle of *pacta sunt servanda* above the principle of legislative sovereignty by providing that:

No law impairing the obligation of contracts shall be passed.

This provision prohibits any law:

which changes the terms of a legal contract between the parties, either in the time or mode of performance, or imposes new conditions, or dispenses with those expressed, or authorises for its satisfaction something different from that provided in its terms

This provision has been held to apply not only to contracts between private entities, but also to contracts between the government and private entities. This has resulted in a number of cases where legislation has been declared void because it impaired the government's obligations under contract. In *Casanova vs. Hord* for example, a tax statute which removed a tax exemption conferred on a mining concession by a Spanish royal decree was declared void under this section.
The protection provided is not absolute, however. The non-impairment provision which embodies it will yield to the Philippine Government's legitimate exercise of its police power, that is, its power to enact laws for the welfare of the people. If the subject matter of the interference is genuinely a matter requiring interference because of its direct relevance to the public welfare and provided that the means used by the state are reasonable and not unduly oppressive to individuals, exercises of this police power will be upheld notwithstanding that the effect may be to impair contractual obligations. A US Court, interpreting the similar provision in its own Constitution, explained the situation in this way:

Not only are existing laws read into contracts in order to fix obligations between the parties, but the reservation of essential attributes of sovereign power is also read into contracts as a postulate of the legal order.

In the past, in an effort to insulate the terms of agreements from unilateral change by subsequent legislation, a number of agreements incorporated stabilisation clauses. Traditionally, these were provisions by which the state purported to guarantee that it would not enact laws that unfavourably changed the rights and obligations of the investor after the agreement had been entered into. A stabilisation provision has been inserted in the Mining Bill itself, which provides:

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All the terms and conditions of a mineral agreement or financial and/or technical assistance agreement under this Act, including fiscal obligations, shall not be impaired, altered or modified unless mutually agreed upon by the contracting parties. 89

The one FTAA and a number of the MPSAs which have been executed to date contain similar stabilisation provisions. Unfortunately the provisions do not make it clear whether the clauses are intended to bind the state in its capacity as legislator. Can these stabilisation provisions do what the non-impairment provision does not do - completely insulate the terms of the agreements from variation by all future legislation including legislation in exercise of the state's police power?

Under the arguments expressed by the arbitrator Professor Dupuy in the TOPCO Arbitration Award90 arguably they could. In that arbitration, Professor Dupuy expressed his view that it was possible for a state, by agreement, to waive its sovereignty with respect to contract related legislative powers for a specified period of time. Yet, even if Professor Dupuy's views were accepted, it appears likely that, as Noel Fabri91 argues, any such stabilisation clauses would be construed narrowly. In the absence of an explicit waiver of legislative sovereignty it appears unlikely that they would be read as demonstrating an intent to render invalid all subsequent legislative revisions.

The opposing view to the waiver of sovereignty standpoint is that by reason of the UN principle of permanent sovereignty over natural resources a sovereign state can never lose its legal

89 Section 100.


91 Fabri, above n 83, 580.
capacity to govern its own territory and resources in the national interest.

Stabilisation clauses have now largely fallen out of use these days, both because they are perceived to be unacceptable to the sovereignty of host countries and because it is generally accepted in most common law jurisdictions that the legislature probably cannot bind future exercises of legislative power. The latter issue remains unresolved, however.92

In the Philippines, in the absence of any express waiver of legislative sovereignty, it appears unlikely that the government intended to give up its rights to exercise its police powers. Accordingly, it seems reasonable to conclude that the stabilisation provisions will be effective to protect the agreements against unilateral variation by the state, but subject to the same proviso as the non-impairment provision, that is, subject to valid exercises of the state's police power. If this conclusion is correct then, from a legal standpoint, the clauses may add little value on top of the existing constitutional protections. Nevertheless, they probably serve an important political function of reassuring potential investors about the stability of the investment regime and reminding the organs of government of their commitment to a stable regime. They may also, as Fabri argues, be a factor to be taken into account when determining the threshold up to which the government is entitled to revise the terms of the regime without being subjected to the obligation to pay compensation.

In addition to the protections given by the domestic laws of the Philippines to the stability of contractual terms there may also be international law protections. The applicability of international law to contracts between host countries and international investors is again an area of considerable controversy, as is the substantive content of any international rules which may apply.93 Supporters of the theory of absolute state sovereignty argue that the contract between a host country and an investor is exclusively subject to national law. In the case of the Philippines mineral agreements, they would be likely to point to the provisions of the mineral agreements which express the agreements to be subject to Philippine law and would argue that international law principles should have no application to the agreement. The opposite view, generally advocated by the capital exporting industrialised countries, is that investment contracts are subject to international law, by reason of their intrinsic international character and other indicators of an internationalisation of the contractual relationship, such as, in the case of the Philippines agreements, the stabilisation clauses and international arbitration provisions.

As to the content of such international law rules, the same debate arises about the pacta sunt servanda principle. Although most supporters of this view would recognise that sovereign states have the right to expropriate property, they argue that if the states does so, it does so in breach of the principle of pacta sunt servanda. This would be a tort under international law and

as a consequence the investor would be entitled to compensation and other remedies through diplomatic action. Under this view there is no exception to the pacta sunt servanda principle for exercises of the police powers of the state. To date the competing positions have not been resolved so the question of the applicability of international law to the Philippine mineral agreements remains open.

The criticism of both the view that the pacta sunt servanda principle is supreme and the view that state sovereignty renders the principle inapplicable to host country / investor relationships is that they adopt extreme positions which do not have regard to the realities of mineral exploration and development. In particular, the latter view fails to give due acknowledgment to the fact that a reasonable degree of predicable in the basic terms and conditions applying to an investment is a pre-requisite to the commitment of large capital, technological and managerial resources to mineral exploration projects. The former view on the other hand fails to allow the host country sufficiently flexibility to govern its affairs for the good of its own people.

It is also starting to be recognised by investors that, whereas protection from change sounds like a good idea, in fact this resistance to change can itself exacerbate the risk of loss of the investment.

The Philippine mineral agreements, like most other such agreements, are extremely long term contracts, with a term of 25 years renewable for a further 25 years. Commonly a title will be granted in the early stages of exploration, prior to the identification of a resource, at a time when it is extremely difficult
to predict the location, size and nature of the resource and, therefore, parameters such as profitability, infrastructure requirements, land use conflicts and personnel requirements. These are all factors which need to be addressed in the contract and which are relevant to the issue of how much return the government and the investor require the project to generate. Throughout the term of the agreement, industry conditions will change rapidly and significantly. Commodity prices fluctuate unpredictably and costs can change rapidly. National policy can also change dramatically in response to domestic events or international factors, perceptions about the value of foreign investment and government participation in resources.

If the regime fails to provide adequate flexibility to be responsive to these types of unexpected supervening events, then there is a risk to the project itself. Where the supervening events are prejudicing the investor, the result is potentially the shut down of the project. Where the events are prejudicing the host country, the impetus towards unilateral use of its police power to amend the terms of the agreement or even expropriation of the property itself may be irresistible to the government of the day. In either event, the consequence is highly likely to be that both the investor and the state lose out.

The reality is that the history of mineral investment contracts in many countries has been one of constant revision and updating. As the lawyer who represented the Bethlehem Steel Corporation in negotiations with the Liberian Government wrote:

94 Smith, above n 31, 128.
the signing of a concession agreement is only the invitation to the ball. ... The foreign investor may feel at times that he has entered into a contract to make concessions rather than a concession contract.95

The real question then, is not how to avoid the contract being modified, but how the almost inevitable process of modification can best be managed to try to achieve consensual outcomes rather than acrimony, public criticism and expropriation and without undue erosion of the investors need for stability. For this reason, the Philippine contractual regime, like most contractual regimes, utilises a number of contractual mechanisms to make the contractual arrangements responsive to changes of circumstances throughout the life of the project.

(b) Adjustment and Variable Royalty Clauses

One method of introducing responsiveness into contracts is through adjustment clauses. These clauses provide for the self-operative adaption of terms of the contract in response to changes in external parameters. These clauses provide flexibility without substantially eroding security as there is generally little room for administrative discretion, the mechanisms for adjustment having been prescribed in advance. An adjustment clause contained in the first FTAA issued provides:

the GOVERNMENT'S share as provided herein may be subject to further reduction by an amount equivalent to whatever benefits that may be extended in the future by the GOVERNMENT to the

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CONTRACTOR or to financial and technical assistance agreement contractors in general\textsuperscript{96}

Somewhat similar to adjustment clauses are variable royalty clauses. An example was considered in \textit{Huggard Assets Ltd. v. AG of Alberta}\textsuperscript{97} where the titleholder was required to pay 'such royalty upon the said petroleum and natural gas, if any, from time to time prescribed by regulations of our Governor-in-Council'. In that case an allegation that this clause was void for uncertainty was dismissed by the Court.

\textit{AO 57/89} allows for a windfall profits share to be payable to the government when the investor's return on investment exceeds a certain agreed reference rate of return, which is a simple form of variable royalty clause.\textsuperscript{98} No matching provision exists however, for reducing the government share when the investor's rate of return falls below an agreed reference rate of return on investment and few, if any, MPSAs to date have included a windfall profits clause.

Both adjustment and variable royalty clauses are really only suitable for adjusting the financial returns of the parties and can only be used for predictable changes with a fairly precisely measurable effect on financial returns, yet within these confines they operate as very effective methods of introducing flexibility to adjust to supervening factors without eroding contractual stability.

\textsuperscript{96} Clause 11.5(h).

\textsuperscript{97} [1953] AC 420; 8 WWR (NS) 561 (PC).

\textsuperscript{98} Article 5.3.
(c) **Compliance With Law Clauses**

The variable royalty clause in the form described in the *Huggard* case also falls within the sub-category of the clauses more generally known as 'compliance with law' clauses, which Lucas describes as:-

> The ultimate link between the Crown's property ownership and legislative capacities.⁹⁹

They essentially require the titleholder to comply with the provisions of the mineral legislation as amended from time to time and make compliance with that legislation a condition of the mineral contract:

There are no general compliance with law clauses in the Philippine regime. The only provisions dealing with the issue at all are in AO 63/91 which provides that the obligations of an FTAA contractor include obligations to:

- g. Pay taxes or obligations in accordance with existing laws, rules and regulations. and
- h. Conform to laws and regulations regarding, among others, labour safety, demarcation of the project area, and non-interference with the rights of other mining operators.

The interesting emphasis in clause g. is the use of the word 'existing'. The section stops short of expressly stating that the contractor does not have to pay any future increases in taxes or

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other (presumably financial) obligations, but this would appear to be the necessary implication of the use of the word 'existing'.

The MPSAs and FTAA issued to date contain similar provisions and specifically require the contractor to comply with the environmental clearance certificate regulation requirements. In fact, as a matter of law, the contractor would be required to comply with all future legislation in so far as it impacts upon its activities provided that the legislation does not either impair the rights or obligations of the contractor under the agreement or else can be said to fall within the government's police powers as previously discussed.

(d) Administrative Discretionary Powers

As previously noted, in any contractual regime the government is likely to reserve to itself significant administrative discretionary powers which allow the government some flexibility in administering the titles. In the Philippine regime the government has retained discretionary powers through the requirement of the government approval of proposed work programs and through the environmental compliance certificate requirements.

These administrative discretionary powers offer considerable scope for the executive arm of government to implement substantial changes to the mineral regime, to the point in some instances where those changes can conceivably be regarded in effect as a form of creeping expropriation. They are not, however, without limits. Exercises of administrative discretion are subject to judicial review, to ensure both procedural fairness and power. Also, as the administrative discretion is conferred
by the provisions of the contract, this may by implication impose
certain parameters upon the exercise of the administrative
discretion, such as the presumption that, at least on private
rather than public issues, the discretion is to be exercised in the
furtherance of the objectives of the contract.

(e) **Force Majeure and Hardship Clauses**

Both force majeure and hardship clauses are designed to
provide relief in situations where unforseen supervening events
or circumstances occur. Force Majeure clauses permit the
automatic suspension of a party's obligations when the
performance of those obligations is rendered impossible by
factors outside that parties control. Hardship clauses establish
a procedure for adjustment of the contract where certain events
cause a party hardship which is capable of being alleviated by
an adjustment of the terms of the investment contract.

Force Majeure clauses have been incorporated in the MPSAs
and the first FTAA, but hardship clauses have apparently not.

(f) **Dispute Resolution Clauses**

Voluntary dispute resolution clauses provide an agreed
mechanism for resolution of disputes. They can take a variety
of forms. They can provide simply that the parties will get
together on a regular basis and review the terms of the
agreement between them, or they can provide that in the event
of some supervening event or a dispute regarding the operation
of the terms of the contract the parties shall in good faith
attempt to negotiate and resolve the dispute between them.
These types of clauses are commonly known as renegotiation clauses. Alternatively, they can provide for arbitration of any such dispute. The Philippine MPSAs and FTAs often include all three types of provisions, with a bi-annual obligation to review the operation of the contract, a requirement that any dispute be first negotiated in good faith between the parties and then provision for international arbitration.

In a strictly legal sense, probably the only legal obligation arising out of renegotiation clauses is a procedural one, i.e. to enter into discussions, as it is not possible to require the parties to reach agreement. Nevertheless, as Smith has noted,\(^\text{100}\) the more formal dispute resolution procedures have rarely been used, the parties instead preferring to resolve issues through negotiation at a political level. Negotiation clauses such as these, serve a valuable function in providing a mechanism for commencing such discussions and reminding the parties of the expectation of flexibility and mutual benefit implicit in these types of relationships.

Considerable importance is placed by many investors upon the availability of international arbitration to resolve private investor/host government disputes. It provides a guarantee that in the event of any dispute as to the operation of the terms of the agreement it will be an independent third party and not the courts of the host country which determine the correct interpretation of the contract. However, as Lucas notes,\(^\text{101}\) whereas arbitration is useful for resolving issues which may not

\(^{100}\) Smith, above n 31, 123.

\(^{101}\) Lucas, above n 99, 302.
have been adequately addressed by the parties in their agreement, it is ill-suited to dealing with system wide issues involving basic policy. Governments are reluctant to cede government policy on national resource regime modifications to an arbitrator as this is perceived to be an unacceptable constraint on government sovereign action. Another limitation of arbitration is that the determination of the arbitral panel cannot directly bind the host country, which is after all a sovereign state. At best, the determination can take the form of a declaration to the host country, failure to heed which will only result in an order for payment of compensation and perhaps diplomatic action. Arbitration also tends to be expensive and time consuming. Accordingly, the effectiveness of arbitration clauses in introducing responsiveness is limited.

D. Other Significant Aspects of the New Regime

1. Administration

Delays in the administration of the mining laws, although rarely fatal, can prove frustrating, expensive and disrupting to exploration/development programs.

One of the biggest advantages about MPSAs is also one of their biggest disadvantages. MPSAs and FTAs are a negotiated form of agreement. Although the government has issued a proforma MPSA in order to assist in the application process, it is quite brief and most international investors will wish to expand somewhat on its terms. Even in the absence of any such deviations, all MPSAs must go through the procedures set out
in the relevant administrative orders, and these procedures are extremely time consuming.

The procedures require a proposal for an agreement to be filed with the relevant regional office, which checks the application and determines whether there is any ground conflict. The applicant must then pay occupation fees and survey the area. The application must then be advertised, the area verified and the proposal then forwarded to an appropriately constituted negotiating panel which is charged with the responsibility of negotiating mutually acceptable terms and conditions. Upon completion of those negotiations the agreement is forwarded to the DENR Secretary for signature, where it is again circulated for comment and its terms renegotiated and amended. It is then forwarded to the President's office for approval, where it is renegotiated again before being approved and registered.

This process is likely to take several years. In fact since 1987, only approximately 19 MPSAs have been finalised, notwithstanding the fact that since 1990 they have been the only method of acquiring a new mineral title in the Philippines. Only one FTAA has yet been fully processed and executed.

The consequences of this delay are not only the extremely long lead time required to commence a new project, but also the amount of land which is being locked up as a result of these procedures.

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As previously noted, real estating is not a new phenomenon in the Philippines. However, it has the potential to be a much worse problem under the new legislation than the old. Although the question of the priority of applications has not actually been dealt with by legislation it is generally accepted by the DENR that, by lodging an application for an MPSA or FTAA, a person can acquire a prior right to a mineral title over that land. In view of the overworked state of the MGB, if that applicant does not choose to follow up on the grant of that agreement, that application may sit on the MGB's files for years without being either granted or rejected. During that period the applicant may be required to pay occupation fees for the land, but will not be required to do any work on the ground because no title has yet been granted. Likewise the area restrictions on MPSAs (10,000 hectares per corporation) presumably do not apply to applications, only to granted MPSAs. Accordingly, there seems to be a strong risk that land will become locked up and that in order to obtain access to ground a genuine explorer will have to enter into agreements to buy out the existing applicants for the ground and then progress the applications to completion. This is an additional cost which will no doubt be factored into the investment decision.

Difficulties in achieving an efficient and effective bureaucracy are, of course, common to many countries. However, the difficulties in the Philippines regime are not merely a function of the tightness of administrative resources, they are also to a large extent structural. The approvals procedure seems to require unnecessarily many different groups separately to review

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and negotiate the agreement. It would be considerably more efficient if all interested parties were represented on the negotiating panel, and if that panel was the sole body charged with the responsibility of reviewing, negotiating and seeking amendments to agreement. Detailed guidelines and policies are also needed to guide the administrators of the regime.

2. **Indigenous Land Rights**

The constitution requires the state to protect the rights of indigenous cultural communities to their ancestral lands.\(^{104}\) Under the new Mining Bill, mineral agreements are not allowed:

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\text{in ancestral lands and/or areas covered by customary mining rights and traditional small-scale miners, unless with the prior consent of the indigenous cultural communities or traditional small-scale miners, in which case a royalty payment upon the utilisation of minerals shall be agreed upon by the parties, said royalty forming a trust fund for the socio-economic development of the community concerned.}^{105}\]

Suggestions have even been made that pre-existing mineral titles should be invalidated if the land they apply to is declared to be ancestral domain, although this would appear to be contrary to the constitutional protections previously referred to and the current draft of the Mining Bill.

No provisions dealing with indigenous land rights were contained in PD 463 and so it is difficult to judge the effect which these issues will have on the regime in the future. Certainly they

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\(^{104}\) Article XII, s 5.

\(^{105}\) Philippine Senate Bill No 1639, s 17.
would appear to have the potential to create significant land access and title security problems in the future.

3. **Small-Scale Miners**

The Philippines has a long history of small-scale mining. The declared policy of the state is:–

> to promote, develop, protect and rationalise viable small-scale mining activities in order to generate more employment opportunities and provide an equitable sharing of the nation's wealth and natural resources, giving due regard to existing rights as herein provided.  

Small scale mining legislation has been enacted which allows small scale miners to apply for small-scale mining contracts over areas suitable for small-scale mining and regulates their activities. Titles are issued by the Provincial Governor rather than the MGB and can be granted over existing titles provided that they are 'not active mining areas'.

This would appear to create a significant security of title issue for prospective mineral explorers. Again, much will depend on how these provisions are implemented.

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106 People's Small Scale Mining Act of 1991 (Phil) (Republic Act 7076), s 2.
107 Ibid.
108 Section 6.
VI. THE REQUIREMENTS OF THE 60/40 RULE

Because of the major impediment which the 60/40 rule represents to foreign investment under the Philippine mineral regime and because, as previously noted, the domestic industry relies so heavily on foreign capital to fund mineral development, the exact requirements of the 60/40 rule have been subject to a good deal of scrutiny from investors over the years. This chapter will examine the practical requirements of the 60/40 rule and mechanisms developed by corporations to manage their investments within its requirements.

As previously noted the 60/40 rule prevents foreign corporations holding more than 40% of the equity in or control over mineral projects. To reiterate, the rule as it currently stands provides that:

The exploration, development and utilisation 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 60 per centum of whose capital is owned by such citizens.109

At first glance, the 60/40 rule seems quite clear; ie. foreigners may only own a 40% interest in resource projects and this must be via an interest in a Philippine incorporated company. Yet when it comes to its application in practice, the ambit of the rule is less clear. What if the company which holds the restricted property (which I will call for the purposes of this paper the 'project company') is itself owned by other companies? Does the rule address direct ownership or does it address indirect ownership? Is it interested only in legal ownership of the company or is it concerned with control? These concepts are related but are not inseparable; in fact, as others have noted:

109 Article XII s 2.
ownership of wealth without appreciable control and control of wealth without appreciable ownership appear to be the logical outcome of corporate development.\textsuperscript{110}

A foreign corporation may obtain access to 64% of the revenue generated by a project and yet still comply with the strict wording of the 60/40 rule. By 'grandfathering', that is, taking a 40% direct interest in the project company and a further 40% interest in the Filipino company which holds the remaining 60% interest in the project company, the foreign investor becomes entitled to around 64% of the equity in the project, that is 64% of the revenue generated by the project. Yet the project company is, at least in the direct sense, only 40% foreign owned and the foreign investor does not control either company.

Control consists primarily of the capacity to choose directors of a like mind to the shareholder. As all the business of a corporation and all its assets and liabilities are controlled and held by the board of directors, whosoever is able to elect a majority of the directors has in effect control or influence over all corporate and business policies. When it comes to voting as a shareholder or via its representatives on the board of directors of the companies, a foreigner under a grandfathering arrangement has only a minority interest in each of the companies and may be out-voted on all issues.

The answers to these questions can have a significant impact on the position of foreign investors wishing to invest under the more favourable financial terms of an MPSA rather than an FTAA.

A. The Control Test

Two legal yardsticks have been developed to help determine the nationality of corporations and these are the 'control test' and the 'grandfather rule'.

The principal test for determining the nationality of a corporation is the control test. Under the control test the nationality of a corporation is determined by the nationality of its controlling shareholders.

This was the determination of the Philippine Supreme Court in Filipina Compania de Seguros v. Christian Huenefeld & Co. Inc. This case did not involve an interpretation of the 60/40 rule, but rather another nationality restriction contained in the Trading with the Enemy Act. In this case the respondent was a company organised under the laws of the Philippines, but which was controlled by German nationals who formed the majority of the shareholders of the company. The petitioner had refused to pay an insurance claim on behalf of the respondent on the grounds that the respondent had become an 'enemy' within the meaning of the Trading With The Enemy Act on the date that the US declared war against Germany. As a result, the petitioner argued that the policy issued in favour of the respondent had ceased to be enforceable. The respondent argued that it was a 'Filipino' entity because it was incorporated under the laws of the Philippines.

The Supreme Court found in favour of the petitioner. It held that the respondent company came within the meaning of the word 'enemy' because it was controlled by enemies.

\[111\] (1951) 89 Phil 54.
B. Grandfathering and the Grandfather Rule

The second yardstick used on several occasions in the past for determining the nationality of companies is the 'grandfather rule'. This rule focuses less on the issue of actual control of the corporation and instead looks at the equity holding of the corporation. The rule originally required that, to determine the Filipino equity in a project company, it was necessary to look beyond the nationality of the corporate shareholders of that project company and consider the nationality of the shareholders of those shareholders.

Whether or not this rule is a valid test of nationality for the purposes of interpreting the constitutional restrictions is unclear. The rule is not the creation of statute or case law, it is a test developed by the administrative officers of government and even the opinions issued by the various executive officers of government are somewhat conflicting.

The case which has come closest to considering the rule was a 1966 Philippine Supreme Court case of Patting v. San Jose Petroleum. In that case the court was called upon to resolve whether San Jose Petroleum Inc. was entitled under the 60/40 rule to hold mining properties. San Jose claimed that it was an American business enterprise and that it was therefore entitled to the benefit of the 1946 parity agreement which granted parity rights to business enterprises 'owned or controlled, directly or indirectly, by citizens of the United States'. The corporate shareholders in San Jose were not American citizens, but a large number of the ultimate shareholders, separated from the project company by four holding companies, were American citizens.

112 (1966) 18 SCRA 924 (Barrera, J).
In order to determine whether San Jose was owned or controlled by American citizens, the court considered not only the nationality of the immediate holding companies of San Jose, but it also considered the nationality of the owners of the immediate holding companies of San Jose. It refused, however, to go beyond this first layer of share ownership to trace the indirect ownership or control by American citizens through the last holding companies in the chain of foreign companies owning San Jose. It held that:-

To hold that the set-up disclosed in this case, with a long chain of intervening foreign corporations, comes within the purview of the Parity Agreement regarding business enterprises indirectly owned or controlled by citizens of the United States, is to unduly stretch and strain the language and the intent of the law. For, to what extent must the word 'indirectly' be carried? Must we trace the ownership or control of these various corporations ad infinitum for the purpose of determining whether the American ownership - control - requirement is satisfied?\textsuperscript{113}

This case can at best stand as an indication that the Philippine Supreme Court may be disinclined to trace ownership back through a number of holding companies. It could be argued to be authority for the view that Filipino ownership should be traced back at least one generation to the owners of the immediate holding companies of the project company. In my view, however, even this interpretation would be extending the decision too far, because the judge appears to have deliberately drawn a distinction between the requirements of the 60/40 rule and the requirements of the parity amendment, which used somewhat different wording. The 60/40 rule, he noted,\textsuperscript{114} applies to 'corporations or associations 60\% of the capital of which is owned by

\textsuperscript{113} Ibid, 93.

\textsuperscript{114} Ibid, 936.
such citizens' and the parity amendment extended the same right to 'business enterprises owned or controlled, directly or indirectly, by citizens of the United States'115 (judges original italics). The 60/40 rule makes no mention of whether the ownership must be direct or indirect, the parity amendment expressly includes both. In reviewing the shareholding of the holding companies it is clear that he considered that he was reviewing whether San Jose was 'indirectly owned and controlled by American citizens'116 within the meaning of the parity amendment. As the 60/40 rule does not require the court to consider indirect ownership the same reasoning would not necessarily apply to that rule.

It is also relevant to note that, in this case, the equity under consideration was the 60% domestic equity component (via the parity rights), it is, therefore, unclear if the same sort of reasoning would apply to the foreign equity component. For both these reasons, in my view, little can be drawn from the case except the conclusion that judges have been reluctant to trace ownership through several holding companies.

Immediately following the handing down of the Palting decision the Securities and Exchange Commission ('SEC') promulgated 'Rules to Implement the Requirement of the Constitution and Other Laws that the Controlling Interests in Enterprises Engaged in the Exploitation of Natural Resources Shall be Owned by Filipino Citizens' of 1967. Those rules amalgamated both the control test and the grandfather rule for the purpose of determining the citizenship of corporations. They provided:

115 Ibid, 927.

116 Ibid, 937 (judges original italics).
THE REQUIREMENTS OF THE 60/40 RULE

Determination of Citizenship in Case of Corporation or Partnership

(a) 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 the corporation or partnership at least 60% of the capital stock or capital, respectively, of which belongs to Filipino citizens, all of the said shares shall be recorded as belonging to Filipinos.\textsuperscript{117}

Accordingly, under this rule, if at least 60% of a corporation is owned by Filipinos it will be deemed to be a Filipino citizen and if it owns at least 60% of another corporation that corporation will also be deemed to be wholly owned by Filipinos. When the Filipino equity in a corporation is less than 60%, however, then only the actual percentage of Filipino equity will be considered to be of Philippine nationality.

This rule, known as the SEC rule, has been reflected in several subsequent pieces of legislation including the Omnibus Investments Code of 1987\textsuperscript{118} and the Foreign Investments Act of 1991\textsuperscript{119} but not in any of the mining laws. The rule has not, however, been tested in court.

The SEC has consistently applied the control test as set out in its 1967 rules. In 1972, for example, it issued an opinion applying the control test in favour of Bancom Development Corporation which was seeking to acquire an equity interest in a mining project company. Bancom was

\textsuperscript{117} Section 7(a).

\textsuperscript{118} Omnibus Investments Code of 1987 (Phil) (Executive Order 226).

\textsuperscript{119} The Foreign Investments Act of 1991 (Phil) (Republic Act 7042).
incorporated in the Philippines and 70% of its capital was owned by Filipino citizens, with the remaining 30% being American owned. The SEC gave its opinion that the whole of the investment by Bancom in the proposed project company would be considered a Filipino investment.  

Unfortunately, the stance taken by the Department of Justice on the control test and the grandfather rule is less straightforward. In 1974, the then Secretary of Justice issued an opinion which seemed to imply that the grandfather rule should be applied in determining the nationality of shareholders. He stated that:-

In the first place, I do not think that the framers of the Constitution in limiting the disposition, exploration, development, exploitation or utilisation of any of the natural resources of the Philippines to citizens or to corporations or associations at least 60% of the capital of which is owned by such citizens, could have intended any interest less than full and absolute ownership by Filipino citizens of the 60% capital. Any other interpretation would do violence to the policy and intent behind these and related constitutional provisions of insuring the conservation of the natural resources of the Philippines for its citizens.  

This created the impression that the Department of Justice considered that the 60% minimum capital stock required by the Constitution to be in the hands of Filipino citizens must be wholly owned by such citizens. This may not, however, have been the intention of the Secretary of Justice as, in that case, the whole of the Filipino equity was being held by the Filipino company merely on trust and not as beneficial owner. The practical effect of this arrangement, the Secretary noted, was that

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120 SEC Opinion of 20.3.72 to E.B. Golden; see, eg, SEC Opinions 21.11.89; 14.12.89; 02.01.90.
the foreign company 'would acquire and own the entire capital stock of the said realty corporation, if not directly at least indirectly'. It appears, therefore, that the opinion probably relied principally on the control test, rather than the grandfather rule, in determining the nationality of the shareholdings of the corporate shareholder.

Subsequent Secretary of Justice opinions on similar transactions all professed to follow Opinion No 171.122 Revealingly, in one of these opinions, the same Secretary of Justice stated that 'in applying the very constitutional provisions now in question the primordial consideration is the situs of control'.123

In 1988, the situation was again cast into uncertainty when the Department of Justice issued an Opinion No 84, Series of 1988, which applied the grandfather rule to calculate whether there was sufficient Filipino equity in the corporation owning land. In that case, the 31% of the capital of the land holding corporation, Silahis International Hotel, was owned directly by Filipino shareholders and the balance (69%) was owned by a company which was in turn 47% Filipino owned. The Department of Justice applied the grandfather rule to compute the Filipino equity to be 63.43%:-

\[
ie. \ 31\% \ (\text{direct}) + \frac{47 \times 69\%}{100} \ (\text{indirect}) = 63.43\% \text{ Filipino equity}
\]

By holding that it was necessary to pierce the corporate veil and go to the citizenship of the shareholders to determine the nationality content,

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the Secretary of Justice appeared to be re-affirming the grandfather rule. Yet, the Secretary was applying it in a most unusual manner to validate a transaction which otherwise would have been invalid for failure of the immediate ownership of the project company to meet the requirements of the 60/40 rule.

In 1989, however, the Secretary of Justice reverted to its previous stance. In that case, Far South East Gold Resources Inc ('FSE') sought approval to engage in mining activities. The capital of FSE consisted of 10,000 common shares, of which 60% were categorised as 'A' Class shares and the remaining 40% were 'B' class shares. 'A' Class shares could be owned only by Filipinos and 'B' Class shares could be owned by Filipinos or foreigners. The 'A' Class shares were held by Lepanto Consolidated Mining Co., which was itself 17% foreign owned.

In its Opinion No 18, Series of 1989 the Secretary of Justice followed the SEC rule and approved the transaction, opining that:

Opinion No 84, s.1988 cited in your query is not meant to overrule the aforesaid SEC rule. There is nothing in the said Opinion that precludes the application of the said SEC rule in appropriate cases. It is quite clear from the said SEC rule that the 'Grandfather Rule', which was evolved and applied by the SEC in several cases, will not apply in cases where the 60-40 Filipino-alien equity ownership in a particular natural resource corporation is not in doubt.

In a subsequent Opinion No 195, Series of 1989 the Secretary of Justice stated that:-

the nationality requirement of the Constitution is essentially based on the primordial consideration that the situs of control, whether in a stock or non-stock corporation should be in the hands of Filipinos.
It is difficult to reconcile the decision in Opinion No 84, Series of 1988 with this reasoning and with the similar reasoning in the other cases referred to.

In summary then, the current status of the 60/40 rule appears today to be that the nationality of a corporation shall be determined according to the control test as reflected in the SEC rule i.e. by the nationality of the controlling stockholders. This has been the apparent view of the legislature, expressed in several pieces of related legislation, it has been the view of the SEC, it is the view of the Mines and Geosciences Bureau\(^\text{124}\) and it has generally been the view of the Secretary of Justice. Even in Opinion No 84, Series of 1988, which appears to support the grandfather rule, the Secretary of Justice himself observed that:-

> The purposes of the 60% requirement is obviously to ensure that corporations and associations allowed agricultural land or to exploit natural resources shall be controlled by Filipinos.\(^\text{125}\)

This rationale would appear to be far better justification for the application of the control test rather than the grandfather rule.

Accordingly, it would appear to be permissible under Philippine law for a foreign company to grandfather, in effect acquiring a 64% share of the revenue from a project by taking both a 40% direct interest in a project company and a 40% interest in the Filipino company which holds the remaining 60% direct interest in the project company. This would go a considerable way towards alleviating the financial

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\(^{125}\) Opinion No 84, Series of 1988; see generally, Opinion No 178, Series of 1974; Opinion No 130, Series of 1985.
consequences of the 60/40 rule and making the regime more financially attractive to foreign investors. Because there has been no judicial consideration of the grandfather rule, however, it is impossible to be confident whether the courts of the Philippines will ultimately uphold grandfathering or not.

In addition to the foregoing issues, any investor considering grandfathering would do well to have regard to the fact that it is also not clear what the consequences would be of a determination by the Philippine courts that the equity structure of a company did not satisfy the requirements of the 60/40 rule. The generally held view is that in those circumstances the court would permit the foreign investor time to divest itself of the excess equity holdings to qualified Filipino citizens. In other words, it would be entitled to retain a 40% equity interest and only divest the balance. This may, however, be over-optimistic.

There have been a number of cases dealing with the situation where land has been transferred to a foreign citizen in breach of the 60/40 rule. In those circumstances the courts have taken the view that this breach renders the sale transaction void ab initio and the property reverts to the original Filipino claimholder.

It is important to note that in the circumstances to which each of these cases related the disqualified individual was in fact wholly foreign in character and accordingly the court did not specifically deal with the issue of what remedy would be appropriate where the disqualified entity was partly Filipino owned and the disqualification could be repaired by divestment of some of the foreign equity to a Filipino entity. As a

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126 Philippine Banking Corporation v. Lui She GR No L-17587, 12 September 1967; 21 SCRA 52; Sarsosa Vda. de Barsobia v. Cuenco GR No L-33048, 16 April 1982; 113 SCRA 547.
matters of strict legal interpretation, as the reasoning of the courts in each case was that the sale was void from the beginning for being 'a contract executed against the mandatory provision of Section 5, Article XIII of the 1935 Constitution'\textsuperscript{127} then no repair of the transaction should be possible. The transaction would be by its nature completely void.

However, as with many issues in the Philippines, the situation is not that clear. Several cases where the foreigner had become a Filipino or had on-sold to a Filipino,\textsuperscript{128} would appear to stand as authority for the proposition that a transaction in breach of the 60/40 rule may not in fact be void but merely voidable. Where the harm was remedied by subsequent transfer or by the owner becoming a Filipino then the transaction was not set aside. Such a result must be highly questionable as a matter of strict legal interpretation, particularly under the current Constitution. The Constitution only empowers the government to enter into mineral agreements with Filipino citizens or corporations at least 60\% owned by Filipino citizens. Accordingly, it would seem to be ultra vires the government to issue or effect the transfer of such rights to non-qualified entities. A foreign investor hoping to rely on these cases as authority may be reassured by the pragmatic attitude taken by the courts to these issues but would be wise to recall that precedent plays a less persuasive role in the Filipino system than in common law jurisdictions.

\textsuperscript{127} Sarsosa Vda. de Barsobia v. Cuenca, above n 126, 552.

It is also relevant to note that under the Anti-Dummy Law, breach of the 60/40 rule is punishable by 'imprisonment for not less than 5 nor more than 15 years'.

C. Corporate Devices Affecting Control

Even if grandfathering is permitted under Philippine law, as noted previously, it increases the revenue share received by the foreign investor but does not give it control of the project.

A number of devices have been developed and are sometimes used by investors in an effort to obtain control of the corporation through the board of directors notwithstanding their minority shareholding interest in the corporation.

1. Proxies

A 'proxy' is the authority given by a shareholder to a third party authorising the third party to vote on behalf of the shareholder at a shareholder's meeting. It may give a general discretionary power to vote on all ordinary matters coming before a regular meeting, or it may be limited to authorising voting on specific matters only and may direct the manner in which the vote shall be cast. Any person may act as a proxy, including another shareholder or directors of the company.

Where shareholders representing 11% or more of the capital of a company issue their proxies to the holder of a 40% interest in

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129 Commonwealth Act No 108 of 1936 (Phil) s 2A.

the corporation that would effectively allow that minority interest holder to exercise majority voting powers.

A foreign investor in the minerals industry, however, would face a number of difficulties in using this device to obtain control. One issue the investor would need to be aware of is that a proxy holder, because it is an agent for the owner of the shares, has fiduciary type obligations towards that shareholder. Accordingly, the voting rights must be exercised in good faith and in accordance with the principal's instructions.\(^{131}\)

Another issue is that the Code provides that no proxy shall be valid and effective for a period longer than five years at one time.\(^{132}\) As mineral projects generally have a life of in excess of five years this means that the security of control provided by the proxy will not last for the whole duration of the project.

A further difficulty is that a proxy is revocable unless it is coupled with an interest in the shares, even if it is declared to be irrevocable. What constitutes a sufficient interest in the shares to make a power to vote them irrevocable is an unsettled question.\(^{133}\) There would certainly appear to be some danger that what would constitute a sufficient interest in the shares to make the proxy irrevocable might also be sufficient to leave the foreign investor exposed to the argument that it has more than a 40% interest in the corporation and thus breaches the 60/40 rule.

\(^{131}\) Rice & Hutchins Inc v Triplex Shoe Co (1929) 147 A 317.

\(^{132}\) Section 58.

\(^{133}\) Nicolas, above n 110, 103.
Finally, even in the absence of any additional interest taken to make the proxy irrevocable, there still would appear to be some question as to whether the granting of the proxy itself could be deemed to breach the 60/40 rule because it falls foul of the control test.

2. **Voting Trusts**

A voting trust is an agreement between a group of shareholders and a trustee whereby they agree that control over the shares owned by the shareholders shall be transferred to the trustee. It is quite similar to a proxy in the sense that the voting rights are quite divorced from the real ownership of the shares. However, unlike a proxy, legal ownership is transferred to the trustee while the shareholder remains the beneficial owner of the shares. A voting trust is also a more effective control device because it may be declared irrevocable without the need to inquire into whether the holder has a sufficient interest in the shares to make the power to vote them irrevocable. A voting trust agreement cannot be terminated by the beneficial owner without the consent of the trustee.

A trustee who collectively holds a majority of the voting shares of the corporation is in a position to elect the directors who hold sympathetic views on matters of corporate management and policies. He may also elect himself as a director.\textsuperscript{134}

There are a number of provisions of the Corporations Code which must be complied with in order for a voting trust to be valid and effective. In particular, the Code requires that the

\textsuperscript{134} Nicolas, above n 110, 111.
voting trust must not be for an illegal purpose.135 Prevailing Philippine opinion goes further and suggests that a voting trust should have a legitimate business purpose to promote the best interests of the corporation. It may, therefore, not be considered valid if it exists only for the benefit of the trustees without any obligation to perform any useful service for the protection of the shareholders or if it unduly restricts the power of the directors. Purposes such as assisting in financing are considered legitimate business purposes.136

Similar difficulties exist for foreign investors in relation to voting trusts as exist in relation to pledge agreements. Most particularly, their term is limited to five years or, where the voting trust is specifically required as the condition of a loan agreement, for the term of repayment of the loan.137 There is likewise the issue of whether such arrangements fall afoul of the control test.

3. **Pooling and Voting Agreements**

Pooling and voting agreements are agreements between shareholders that are designed to specify the persons to be elected as directors or to combine votes as a unit. They are different from voting trusts in that the shareholders remain the legal owners of the shares and retain the rights to vote, however, they undertake to bargain their right to vote according

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135 Corporations Code, above n 130, s 59.
136 Nicolas, above n 110, 109.
137 Section 59.
to their best judgment. Various mechanisms are established to ensure collective voting and to resolve disagreements, such as agreeing that the stock must be voted in accordance with majority decisions or with the decision of an arbitrator in the case of disagreement.

In a voting trust, the trustee determines policy and votes accordingly on behalf of the beneficiaries. Under a voting agreement, the shareholders have the initial choice to determine policy and the third party arbitrator only serves to resolve conflict.

Voting agreements are recognised by the Corporations Code and by Philippine authorities as valid and binding if they do not tend to limit the discretion of the directors nor create any fraud, oppression or wrong against other shareholders.

4. **Cumulative Voting**

The Corporations Code provides that a shareholder entitled to vote:

> shall have the right to vote the number of shares of stock standing at the time fixed in the by-laws in his own name on the stock books of the corporation for as many persons as there are directors or he may cumulate said shares and give one candidate as many votes as the number of directors to be elected multiplied by the number of his

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139 Ringling v Ringling Brothers (1946) 49 A 2d 603.
140 Section 100.
shares shall equal, or he may distribute them on the same principle among as many candidates as he shall see fit.\textsuperscript{142}

The object of cumulative voting is to give the minority the opportunity to elect at least one director to the board. For example, suppose that a corporation has 1,000 shares outstanding, all of which will be voted at the meeting at which a 5 person board of directors is to be elected. The minority shareholder controls 400 shares and the majority shareholder controls 600 shares. The minority shareholder, therefore, has a total of 2,000 votes, obtained by multiplying 400 by 5 and the majority shareholder would have 3,000 votes. By dividing its votes equally between two candidates the minority shareholder can elect two directors with 1,000 votes each. The majority shareholder may only elect 3 candidates, the highest possible number of votes for its respective candidates being 1,000 votes.

As noted by Nicolas,\textsuperscript{143} however, in some circumstances cumulative voting can be used by a minority shareholder to obtain more representation than it is entitled to. In the example above, if the majority shareholder had put forward 5 nominees and failed to cumulate its votes, i.e. casting 600 votes for each and the minority shareholder cumulates its votes on three candidates, casting 668, 667 and 665 votes respectively, the minority can elect three directors and have majority control of the board.

\textsuperscript{142} Section 24.

\textsuperscript{143} Nicolas, above n 110, 116.
5. **Classification of Shares and Directors**

The Corporations Code allows the classification of shares but provides that no share may be deprived of voting rights except those classified and issued as 'preferred' or 'redeemable' shares.¹⁴⁴ This prohibits the practice in some common law jurisdictions of issuing non-voting common stocks for control. This provision does not, however, prevent some restrictions on voting rights. By having two classes of shares only one of which is entitled to vote for directors, ownership of the majority of that class of shares is sufficient to give legal control and virtually all the powers of majority ownership. A similar device is provided by Section 97 of the Corporations Code to close corporations, which permits the company's articles to provide for a classification of directors into one or more classes, each of whom may be voted for and elected solely by a particular class of stock.

6. **Prescribing Qualifications for Directors**

Under the Corporations Code¹⁴⁵ a corporation is permitted to prescribe qualifications for its directors provided that they are not inconsistent with the qualifications prescribed by law. The test is what is reasonable to promote the efficient management of the corporation.¹⁴⁶ It is permissible, for example, to provide that only holders of 'founder's shares' may become directors for a period of up to 5 years after commencement. Like all of the

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¹⁴⁴ Section 6.

¹⁴⁵ Section 47(5).

¹⁴⁶ Nicolas, above n 110, 124.
forgoing voting arrangements there is the issue of whether such arrangements breach the control test and anti-dummy law.

7. **Restrictions on Transfers of Shares**

The Corporations Code permits a close corporation to impose restrictions on the transfer of its shares, provided that those restrictions are not more onerous than granting the existing shareholders the option to purchase the shares. This mechanism may be used as a method of control where management wishes to prevent the transfer of shares from friendly or indifferent shareholders to unfriendly third parties, but is otherwise limited in its application.

8. **Minority Protection Devices**

Minority protection devices which provide for super-majority voting and restrictive quorum requirements may be incorporated in the company's articles.\(^{147}\)

Commonly the capital of a project company with mixed Filipino and foreign equity will be divided into A and B class common shares with the A class shares being restricted to Filipinos and the B class shares being available to foreigners.\(^{148}\) The minority protection devices will then provide that the B class shareholders shall have the right to nominate certain directors and officers of the corporation and that the quorum for all meetings of shareholders shall be super-majority (e.g. 70%) to

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\(^{147}\) Section 25.

\(^{148}\) Eg, Far Southeast Gold Resources Inc, see page 95.
ensure that the foreigner's presence will be indispensable at all meetings of the company shareholders. It is also possible to require that at least one director nominated by the B class shareholders shall be a necessary part of any quorum for board meetings and their favourable vote must form part of the majority required to pass any board resolution. Particularly sensitive matters such as the amendment of the Articles of Incorporation, disposal of company property, dealings with indebtedness, etc. may specify that those resolutions need the approval of a supermajority of directors.

The limitation on such minority protection devices is that necessarily by their nature they are veto rights, allowing the minority interest holder to prevent the majority interest holder causing the corporation to take certain actions. They cannot be used by the minority interest holder to require the company to take action which the majority interest holder does not agree with. For this reason, it seems unlikely that such devices will fall foul of the control test and the anti dummy law, provided that the super-majority requirements are not extended so widely as to go beyond minority protections and constitute an effective transfer of control over the companies activities.

D. Loans

Another mechanism for increasing the foreign revenue and obtaining some control over the management of the project is via the terms attached to financing extended by the foreign company to the Filipino shareholder or to the project company itself.
These arrangements are scrutinised extremely closely by the Philippine administration and if there are any terms which cannot be justified as being in accordance with internationally accepted terms, the transaction is unlikely to be approved on the grounds that it is in breach of the anti-dummy law.

E. Management Contracts

The Corporations Code specifically recognises management contracts. It requires that they be approved by the majority of the board of directors and shareholders, or, if the managing corporation is related to the managed corporation, by two thirds of the shareholders of the managed corporation. It also specifically confirms that, in the case of agreements relating to natural resources, they may only be entered into for the periods allowed under the pertinent laws.

These provisions have given rise to the practice of 60/40 project companies entering into agreements with foreign corporations for those foreign corporations to manage the exploration / mining operations. Not uncommonly, it will be the foreign 40% interest holder in the 60/40 corporation which is appointed as the manager under the management agreement.

As with the other mechanisms I have considered there is no judicial consideration of the validity of these arrangements under the 60/40 rule. There have, however, been a number of opinions issued by the Secretary of Justice which make it clear that these arrangements will be viewed with close scrutiny to ensure that the foreign company is permitted to manage only the ordinary day to day project activities. The board of the 60/40 company must retain control and management

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149 Section 44.
of the project as a whole and power to make all major project
decisions. The principles which will be applied will be substantially
similar to those applied to service contracts under PD 463. This will
presumably include the limitations on the return to the foreign company
to 40% of the projects net revenue, whether by way of payment for
services rendered or by way of dividends.

Provided that the investor obtains the prior approval of the Director of
Mines to the management contract and all foreigners employed
thereunder, it appears that the investor can be reasonably confident
that a management agreement would withstand any legal challenge
and provide a reasonable amount of control over the day-to-day project
decisions. Coupled with minority protection devices and a
grandfathering arrangement, it may be possible for an investor to obtain
a fair amount of control and a fair proportion of the equity in a project.
It would, however, fall short of full control and would not be without risk.

F. Non Mining Activities

One other possible method for a foreign investor to increase its share
of a mineral project relies on the exact wording of the 60/40 rule. As
enacted in 1935, the rule covered the 'disposition, exploitation,
development or utilisation' of mineral resources. This led to the
conclusion that the exploration for and processing of minerals were not
covered by the rule.

There is certainly some good reasons why the constitutional framers
may have deliberately intended these activities to fall outside the rule.

150 Secretary of Justice Opinion No 45, Series 1975.
151 See discussion at 29.
Both exploration and processing are less attractive to private investors than mining, as both require large capital investment and exploration in particular is a very risky activity. For these reasons, the constitutional framers may have intended to encourage foreigners to undertake these activities by allowing 100% foreign participation at these stages.

This view has now been reflected in the Mining Bill which, in its current form, makes allowance for two new types of title which are not referred to in the Constitution - an exploration permit and a minerals processing permit. The Mining Bill specifically states that both permits may be issued to foreign corporations.

These permits should in theory prove highly attractive to foreign investors and again constitute a method whereby the investors can increase their control over and share of revenue from the project. Yet again, however, despite the apparent endorsement of the concept by both the executive and the legislative arms of government, there would appear to be some questions hanging over the validity of such permits. The wording of Article XII of the Constitution has changed somewhat over time and now restricts the 'exploration, development and utilisation' of natural resources. This would seem to squarely catch exploration within the requirements of the 60/40 rule. There is also a grey area regarding what constitutes 'utilisation'. It is extremely unlikely that 'utilisation' was intended to cover all downstream processing of minerals right up to the time, for example, that a car runs off the end of an assembly line in Japan, but it is extremely unclear at what point activities cease to be covered by the rule. Presumably a fair cut off point would be the point at which minerals have been treated to first commercially saleable product. There is currently no judicial or legislative support for this proposition, however.
Yet again the exploration permit and minerals processing permits are mechanisms which show some promise, but which, in the former case particularly, involve some degree of risk to the foreign investor.
VII. CONCLUSION

The purpose of this paper has been to examine the new Philippines mineral regime and to assess whether the mineral investment package now being offered to foreign investors is a substantial improvement upon that offered under the previous regime. That examination has revealed a number of quite positive changes.

The introduction of the mineral agreement style of mineral title is the most significant change introduced by the new regime and represents a substantial improvement on the old regime. By negotiating and agreeing upon the major terms and conditions of the mineral agreement, the parties can tailor the arrangements to suit the individual characteristics of each project and the preferences and needs of the individual investors. The regime emphasises the consensual and mutually beneficial nature of the relationship between the parties and reinforces the expectation of an ongoing relationship of co-operation and mutual problem solving.

The contractual style of title has also improved on two of the main issues of concern to foreign investors, that is, security of title and stability of the investment regime. The introduction of long term, integrated titles which give rights to conduct 'cradle to grave' mineral activities is a considerable improvement on the system under PD 463, where separate titles were granted for the separate stages of exploration and mining. An investor is no longer exposed to the risk that after expenditure of significant funds on exploration and the discovery of an orebody the investor might not be granted a mining lease permitting it to mine the discovery, nor that the terms under which that lease was to be granted might be different than anticipated when the exploration commenced.

The contractual titles also provide title holders with a higher degree of protection from subsequent unilateral variation of the terms of the agreement by the government. Because of the constitutional prohibition on laws
impairing the obligation of contracts, the terms of mineral agreements are comparatively well insulated from the impact of subsequent legislation which could otherwise operate to modify the parties' rights and obligations under the agreements. The stabilisation provisions in the mineral agreements and in the Mining Bill reinforce this resistance to unilateral change. The agreements have, however, been made responsive to changing circumstances without unduly eroding the stability of the agreement by the inclusion of a number of mechanisms such as dispute resolution clauses, force majeure provisions, adjustment clauses and the incorporation of administrative discretion in the approval of work programs.

The amount of control which foreign investors can exercise over their investment has also improved substantially. Under an FTAA an investor has a direct contracting relationship with the government. Accordingly, a foreign investor is entitled to manage the project in its own name and is no longer restricted to taking a minority interest in the project company or working under a service contract with a Filipino project company. The emphasis upon FTAAAs being subject to the government's full control and supervision may cause a prospective investor some initial concern, however, on current indications that concern would appear unfounded. Despite the fact that the new titles available to foreign investors are characterised as 'assistance agreements', the mechanisms for state control and supervision appear reasonable and have not changed substantially from those utilised under the old regime. The approval of work programs and budgets and the submission of annual reports will remain the principal mechanism for on-going government control and supervision.

All of these features of the new regime are likely to be viewed favourably by foreign investors.
Under both the old regime and the new regime investors have the benefit of reasonable constitutional guarantees regarding expropriation and requisition of property so the situation has changed little in this regard. Likewise under both regimes an element of insecurity exists by virtue of the fact that the mineral titles do not confer government approvals under other legislation such as environmental legislation, however, again the position has not changed in this regard.

The provisions in the new regime for the protection of indigenous land rights and the new small scale mining legislation have introduced new insecurities which could have a serious impact on investor security of title in the future. However, it is too early to judge the effect which these will have in practice.

The provisions for the administration of the new mineral regime are also an improvement on the PD 463 regime. The PD 463 regime was inflexible, arbitrary and adversarial. In particular, its reliance on deemed automatic abandonment for various non-compliances made the system rigid, which in turn resulted in some instances in the administration administering the regime contrary to the express terms of the legislation. This generated confusion and security of title problems. The new regime is more flexible, less arbitrary and technical breaches are unlikely to result in loss of the mineral title. However, one of the major difficulties with the old regime was that it was not always consistently and efficiently administered and this problem appears to have continued under the new regime. The new regime also does not deal with the questionable validity of the old PD 463 claims and delays in the processing of the mineral titles may cause additional problems with large areas of land being held under application for long periods without being worked or dropped.

But, notwithstanding all of the foregoing improvements, the 60/40 rule, which was cited as being 'the most significant commercial disincentive to the foreign
investor in the Philippines' has been retained. Although voting structures and other mechanisms have been used by a number of companies to avoid some of the financial and control consequences of the 60/40 rule, some with some positive benefits, none of these mechanisms allow an investor to safely structure their investment to increase their return above 40% and exercise control over the project. In particular, grandfathering may increase a foreign investors return but does not give it control and FTAAAs give it control (subject to overall government control) but restrict it to 40% of the return.

The governments refusal to take advantage of the opportunity provided by FTAAAs to move away from the 60/40 rule, despite a fairly clear constitutional mandate to do so, is perplexing. Notwithstanding the 1990 Secretary of Justice opinion which suggests that FTAAAs may be legally bound by the 60/40 rule, there are extremely good grounds for the view that they are not. Yet, despite being aware of the questionable nature of the opinion and the impediment which the rule represents to its efforts to attract foreign investment, the government continues to regard FTAAAs as bound by the 60/40 rule.

Or perhaps this is a misinterpretation of the governments position. It may well be politically unattractive to the government to put aside the 60/40 rule, even if it is legally possible for it to do so. The rule has existed since 1935. Notwithstanding that the weight of opinion in senior government and business circles now supports the liberalisation of nationalist restrictions, it is apparent that a large proportion of the Philippine people still ascribe considerable emotional value to the rule. In fact, the 1986 constitutional debates appeared to suggest that there was more support for making the restrictions tighter than there was for loosening them. Yet the government cannot help but be aware that it needs foreign investment if it is to develop its mineral resources and

\[152^{\text{ANZ Chamber of Commerce (Philippines) Inc, above n 57.}}\]
that it will not generate this investment without a competitive mineral law regime.

This may be why, although the government has to date remained apparently firm in its insistence that revenue sharing under FTAAAs complies with the requirements of the 60/40 rule, when it is determining the manner in which it is calculated it has made a number of concessions which preserve the form of 60/40 revenue sharing but improve the return to the contractor.

Although this may be a politically attractive solution, however, it is not an attractive solution from the perspective of the foreign investor. Notwithstanding the legality of these concessions, investors entering into such agreements may well be open to subsequent public criticism of the type levelled against service contractors under the PD 463 regime, ie. that they are using 'loopholes' to 'get around' the law. Few investors will relish being placed in such a position, particularly when from a legal standpoint it appears unnecessary to structure the agreement in this manner. Also, because the concessions are still required to fit within an overall framework of 60/40 profit sharing, there is a limit to their value. Accordingly, the contractors return under FTAAAs is still substantially less than the contractors return under MPSAs and appears to be only a small improvement on the financial terms available to foreign investors under service contracts under PD 463. As previously noted, service contracts were not successful in attracting significant foreign investment into the Philippine mining industry.

An improving world economy, renewed investor interest in the Asia region and the positive improvements contained in the new mineral regime are likely to see foreign investment in the Philippine mining industry increase somewhat over the coming years. It is, nonetheless, extremely unfortunate that, given the constitutional mandate to move away from the 60/40 rule in FTAAAs, the government has to date failed to seize this opportunity and withdraw its
requirement for divestment and 60/40 profit sharing. Unless it does so it appears that the new mineral laws are likely to be an opportunity missed. It is to be hoped that the Philippine government reassesses its stance on this issue in the near future in order to attract foreign investment and create a thriving minerals industry capable of making a substantial contribution to the Philippine economy.
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MINERAL PRODUCTION SHARING AGREEMENT

This MINERAL PRODUCTION SHARING AGREEMENT (this "Agreement") is made and entered into in Quezon City, Metro Manila, Philippines, this 1st day of January, 1981, by and between:

THE REPUBLIC OF THE PHILIPPINES, represented by
the Secretary of the Department of Environmental and Natural Resources, with offices at the Department of Natural Resources Building, Visayas Avenue, Diliman, Quezon City, Metro Manila (the "Government")

-and-

THE CONTRACTOR, a corporation duly organized and existing under the laws of the Republic of the Philippines, with offices at

(Witnesess)

WHEREAS, the 1987 Constitution of the Republic of the Philippines (the "Constitution") provide in Article XII, Section 2, that all lands of the public domain, waters, minerals, coal, petroleum, and other natural resources are owned by the State, and that the exploration, development, and utilization of natural resources shall be under the full control and supervision of the State; and

WHEREAS, the Constitution further provides that the State may directly undertake such activities, or it may enter into cooperation, joint ventures, or production sharing agreements with Filipino citizens, or corporations or associations at least sixty per centum of whose capital is owned by such citizens; and

WHEREAS, by Executive Order No. 279 issued on July 25, 1987, the Secretary of the Department of Environment and Natural Resources is authorized to enter into production sharing agreements in furtherance of the objectives of the Government and the Constitution as they affect the national economy through systematic development and utilization of mineral lands; and

WHEREAS, the Government desires to avail itself of the financial resources, technical competence, and skills which Contractor is capable of applying to the Mining Operations of the project contemplated herein; and

WHEREAS, Contractor desires to join and assist the Government in the development and utilization for commercial purposes of certain deposits existing in the Contract Area (as hereinbefore defined) and any other minerals which may be discovered in such Contract Area; and

WHEREAS, Contractor has available to it the capital, technical competence and skills necessary to carry out the Mining Operations herein described.

NOW, THEREFORE, for and in consideration of the premises, the mutual covenants, terms and conditions hereinafter set forth, it is hereby stipulated and agreed as follows:

SECTION I

SCOPE

1.1 This agreement is a mineral production sharing agreement entered into pursuant to Executive Order No. 279. The primary purpose of this Agreement is to provide for the exploration, development, and commercial exploitation of certain mineral deposits existing within the Contract Area, with all necessary services, technology and financing to be furnished or arranged for by the Contractor in accordance with the provisions of this Agreement. The Contractor shall not, by virtue of this Agreement, acquire any title to lands encompassed within the contract area.

1.2 The Contractor shall undertake and execute, for and on behalf of the Government, Mining Operations in accordance with the provisions of this Agreement, and is hereby constituted and appointed for the purposes of this Agreement the exclusive entity to conduct Mining Operations in the Contract Area.

1.3 The Contractor shall assume all exploration risk such that if no Minerals in commercial quantities are developed and produced, it will not be entitled for reimbursement.

1.4 During the term of this Agreement the total value of production and sale of Minerals derived from the Mining Operations contemplated herein shall be accounted for and divided between the Government and Contractor in accordance with Section VIII hereof.

SECTION II

DEFINITIONS

As used in this Agreement, the following words and terms, whether in the singular or plural, shall have the following respective meanings:

2.1 Agreement means this Production Sharing Agreement.

2.2 Associated Minerals means ore minerals which occur together with the principal ore mineral.

2.3 Budget means an estimate of expenditures to be made by Contractor in Mining Operations contemplated hereunder to accomplish the Work Program for each particular period.

2.4 Calendar Year or Year means a period of twelve (12) consecutive months starting with the first of January and ending on December 31, while "Calendar Quarter" means a period consisting of three (3) consecutive months with the first calendar quarter starting with
the first day of January.

2.5 Central Bank means the Central Bank of the Republic of the Philippines.

2.6 Commercial Production means the production of sufficient quantity of minerals to sustain economic approved Work Program. Production of minerals shall be by test and/or develop a processing system or supply a pilot plant used for such testing in quality and volume specified in the approved Work Program Commercial Production.


2.8 Contract Area means the area within the jurisdiction of the Republic of the Philippines which is the subject of this Contract, as diminished pursuant to the relinquishment obligations of the Contractor as herein set forth.

2.9 Contract Year means a period of twelve (12) consecutive months counted from the Effective Date of this Agreement or from the anniversary of such Effective Date.

2.10 Contractor means or assigns of any interest of this Agreement provided such assignment of any such herein.

2.11 Declaration of Mining Feasibility means a document on the presence of minerals in a specific area, which is recoverable by socially acceptable, environmentally safe and economically sound methods included in the Mine Development Plan for a period of three (3) years in the case of Integrated Agreement.

2.12 Effective Date means the date of this Agreement set forth above.

2.13 Environment means physical factors of the surroundings of human beings, including land, water, atmosphere, climate, sound, odor, taste and biological factors of animals and plants and the social factors of aesthetics.

2.14 Executive Order means that certain order of the President of the Philippines issued on July 25, 1937 and known as Executive Order No. 279.

2.15 Exploration means the examination and investigation of lands and offshore areas supposed to contain valuable minerals by drilling, trenching, shaft sinking, tunneling, test pitting and other means, for the purpose of probing the presence of mineral deposits and the extent thereof.

2.16 Exploration Period shall mean the time period from the Effective Date of this Agreement and actual activities in the Contract Area shall commence not later than three (3) months after signing the Contract. The Exploration Period shall be for at most two (2) years from the Effective Date of this Agreement, as may be extended with the consent of the Government by not more than two (2) years or a maximum total of four (4) years from Effective Date of this Agreement.

2.17 Force Majeure means acts of any circumstances beyond the reasonable control of the Party to this Agreement affected thereby, including, without limitation, war, insurrection, civil disturbance, blockade, sabotage, embargo, strike and other labor conflict, riot, epidemic, earthquake, storm, flood or other adverse weather conditions, explosion, fire, act of God or the public enemy, breakdown of machinery having a major effect on the operations, and any cause (whether or not of the kind hereinbefore described) over which the affected party has no reasonable control and which is of such a nature as to delay, curtail or prevent timely action by the party affected.

The force majeure mentioned in this section, except those of general knowledge, shall be reported to DENR Regional Office concerned within fifteen (15) calendar days from occurrence.

2.18 Foreign Exchange means any currency other than that of the Republic of the Philippines acceptable to the Government and the Contractor.

2.19 Government means the Government of the Republic of the Philippines or any of its agencies or instrumentalties.

2.20 Gross Output means the actual market value of mined or mineral products derived from mining operations as defined under the National Internal Revenue Code.

2.21 Market Development means refers to steps necessarily taken to reach an orebody or mineral deposit so that it can be mined.

2.22 Minerals means all naturally occurring inorganic substances in solid, liquid, or any intermediate state.

2.23 Mineral Products means things produced and prepared in a marketable state by simple treatment processes such as washing or drying, but without undergoing any chemical change or processes or manufacturing.

2.24 Mining Area means that portion of the Contract Area delineated for mine development and production, as specified in the Declaration of Mining Feasibility.

2.25 Mining Operations means mineral exploration, development, production, and all other operations necessary to discover, develop and extract minerals.

2.26 Net Revenue means the gross output as defined herein less expenditures such as mining, milling, royalties, depletion and depreciation as computed for tax purposes.
2.27 **Notice** means notice in writing, or by telex or telexing (authenticated by answer back or confirmation received), addressed or sent as provided in Section 14.1 of this Agreement.

2.28 **Ore** means mineral or rock extracted for profit.

2.29 **Ore-Mineral** means a mineral that can be extracted from ore and contributes to the value of the ore.

2.30 **Pollution** means any direct or indirect alteration of the physical, thermal, chemical, biological, or radioactive properties of any part of the Environment by discharging, emitting, or depositing wastes so as to materially affect any beneficial use adversely, or to cause a condition which hazardous or potentially hazardous to public health, safety, or welfare, or to animals, birds, wildlife, fish or aquatic life, or the plants, and "pollute" has a corresponding meaning.

2.31 **Secretary** means the Secretary of the Department of Environment and Natural Resources.

2.32 **Department or GENR** means the Department of Environment and Natural Resources.

2.33 **Work Program** means a document which presents the plan of major mining activities and the corresponding expenditures and Budget of the Contractor in its Contract Area during a given period of time, including the plan and expenditures for Environmental protection and rehabilitation, development of host and neighboring communities and of local geosciences and mineral technology, as submitted and approved pursuant to this Agreement.

**SECTION III**

**TERM OF AGREEMENT**

3.1 The initial term of this Agreement shall be twenty-five (25) Contract Years from the Effective Date, subject to termination as provided herein, renewable for another period of twenty-five (25) years under such terms and conditions as may be mutually agreed upon by the parties.

**SECTION IV**

**CONTRACT AREA**

4.1 **Size, Shape and Location of Contract Area.** This Agreement covers an area of

and bounded with the following geographical coordinates:

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<th>Longitudes</th>
<th>Latitudes</th>
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<td>14. Corner 14</td>
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</table>

The specific size and shape of the Contract Area is indicated in a map/sketch with corresponding geographical coordinates, as shown in Annex A.

**SECTION V**

**EXPLORATION PERIOD**

5.1 **Timetable for Exploration.** Contractor shall commence Exploration Operations hereunder not later than three (3) months after the Effective Date. This exploration phase shall be extended for not more than two (2) years upon request by the Contractor and upon the government being satisfied that the Contractor has complied with the terms of this Agreement and of reasonable expectation of success during the extension.

5.2 **Work Program and Notices.** The Contractor shall strictly comply with the Exploration Work Program submitted to and approved by the Government.

The amount to be spent by the Contractor in conducting Exploration Operations to the terms of this Agreement and during the Exploration Period shall, in aggregate, be not less than that hereinafter specified for each of the below specified Contract Years as follows:

First Contract Year:

Second Contract Year:

In the event of the termination of this Agreement, Contractor shall only be obligated to spend the pro-rated amount for the period of such Contract Year prior to
In the event of extension, the amount to be spent every year shall first be agreed upon the parties.

If during any Contract Year, Contractor should expend more than the amount required to be expended as provided above, the excess may be subtracted from the amount of money required to be expended in the succeeding Contract Year, and annual Consent of the Government is required for additional expenditures during a Contract Year than the amount required to be so expended, the deficiency shall be applied to the amount required to be expended by Contractor in the succeeding Contract Year.

5.3 Regulatory Fees - There shall be due to the Government for regulatory purposes, in addition to any existing administrative fees, the following fees during the exploration period:

First Year - Ton Pesos ($P 10.00) per hectare
Second and subsequent years - the amount per hectare for the initial year plus a yearly increment of Five Pesos ($P 5.00).

The regulatory fees corresponding to the first two (2) Contract Years shall be payable within thirty (30) days from Effective Date. While the regulatory fees for the extension period shall be due within thirty (30) days from approval of the request for extension of the Exploration Period.

The regulatory fees shall be paid to, and on the date the Agreement is registered with, the MNR Regional Office concerned, and on the same date and place every year thereafter.

5.4 Remittances -

a) Annual Report - During the Exploration Period, the Contractor shall supply all geological, geophysical, radiometric and other information relating to the exploration areas and its activities, by annual reports in triplicate, within sixty (60) days from the end of the reporting year. Such reports shall include each Contract Year. Such reports shall include financial expenditures, raw and processed analytical data, copies of original reports, and all other information. All such information shall be confidential, subject to the provisions elsewhere provided therein.

b) Final Report - The Contractor shall submit a final report within six (6) months from the expiration of the Exploration Period and shall incorporate all the findings in thecontract Area, including locations of samples, assays, chemical analysis, and assessment of mineral potential. Such report shall also include complete, detailed expenditures incurred during the Exploration Period.

Mining Feasibility - During the Exploration Period, the Contractor shall conduct feasibility studies for any part of the Contract Area. He shall submit a Declaration of Mining Feasibility with a Work Program for development for the next three (3) years indicating the Mining Area. Areas not delineated as part of the Mining Area shall be deemed relinquished in favor of the Government.

Failure of the Contractor to submit a Declaration of Mining Feasibility during the Exploration Period shall be considered a substantial breach of this Agreement.

SECTION VII:

DEVELOPMENT AND CONSTRUCTION PERIOD

6.1 Timetables - The Contractor shall complete the development of the mine, including the construction of production facilities within thirty-six (36) months from the submission of the Declaration of Mining Feasibility, subject to such extension based on justifiable reasons as the Secretary may approve.

6.2 Records -

a) Annual - Contractor shall submit an annual report within sixty (60) days after December 31 of each year which states the major activities, achievements, and expenditures during the year, including maps, assays, rock and mineral analyses, and similar reports during the development and construction period.

b) Final Report - Within six (6) months from the completion of the development and construction projects, the Contractor shall submit a final report to the Secretary. Such report shall include all information in maps of appropriate scale and quality as well as in monographs or reports in accordance with international standards.

SECTION VIII:

OPERATING PERIOD

7.1 Timetables - The Contractor shall submit within thirty (30) days from the expiration of the construction facilities a Work Program for a period of three (3) years. The Contractor shall commence Commercial Production immediately upon the approval of the said Program. Failure of the Contractor to commence Commercial Production within the period shall be
7.2 Work Programs - During the Operating Period, the Contractor shall submit to the Government, Work Programs covering a period of three (3) years each which shall be submitted not later than thirty (30) days before the expiration of the period covered by the previous Work Program. The Contractor shall conduct Mining Operations and other activities for the duration of the Production Period in accordance with the duly approved Work Program and any modification thereof approved by the Secretary.

7.3 Reports -

a) Quarterly Reports - Beginning with the first Calendar Quarter following the commencement of the Operating Period, the Contractor shall submit within thirty (30) days after the end of each Calendar Quarter a Quarterly Report stating the tonnage of production in terms of ores, concentrates, and their corresponding grades and other types of products; value, destination of sales or exports and to whom sold; terms of sales and expenditures.

b) Annual Reports - During the Operating Period, the Contractor shall submit within sixty (60) days from the end of each Calendar Year an Annual Report indicating in sufficient detail:

11. The total tonnage of ore reserves whether proven, probable, or inferred; the total tonnage of ores, kind-by-kind, broken down into the ores mined, tonnes transported from the mine and their corresponding destination, tonnes shipped to the mine, and elsewhere in the Philippines; tonnes sold or committed for export whether actually shipped from the Philippines with full details as to purchaser, destination and terms of sales, and if known to the Contractor, tonnes refined, processed or manufactured in the Philippines with full specificity as to the intermediate products, by-products, original products and of the terms at which they were disposed.

1. Work accomplished, and work in progress at the end of the year in question with respect to all of the installations and facilities related to the utilization program, including the investments actually made or committed.

ii) Profile of work force, including management and staff, stating particularly their nationalities, and for Filipinos their place of origin (i.e., barangay, town, province, region).

iv) Ownership of the Contractor, particularly with respect to nationality.

7.4 Expansions and Modifications of Facilities - The Contractor may, upon approval of the Secretary, add new facilities or make modifications and replacements of the mining facilities and may add new facilities or make modifications and replacements of the mining facilities and may add new facilities or make modifications and replacements of the mining facilities and may add new facilities or make modifications and replacements of the mining facilities and may add new facilities or make modifications and replacements of the mining facilities and may add new facilities or make modifications and replacements of the mining facilities and may add new facilities or make modifications and replacements of the mining facilities and may add new facilities or make modifications and replacements of the mining facilities and may add new facilities or make modifications and replacements of the mining facilities and may add new facilities or make modifications and replacements of the mining facilities and may add new facilities or make modifications and replacements of the mining facilities and may add new facilities or make modifications and replacements of the mining facilities and may add new facilities or make modifications and replacements of the mining facilities and may add new facilities or make modifications and replacements of the mining facilities.

SECTION VIII - FISCAL REGIME

8.1 General Principles - The financial regime of this Agreement shall be governed by the principles according to which the Government expects a reasonable return in economic value for the utilization of non-renewable natural resources under its natural sovereignty while the Contractor expects a reasonable return on its investment with special account to be taken for the high risks of high risks of exploration, the terms and conditions prevailing elsewhere in the industry and any special efficiency to be gained by particularly gold performance of the Contractor.

8.2 Occupation Fees - Commencing from the effective date, the contractor shall pay within thirty (30) days after the end of each Calendar Year to the Government an occupation fee over the Contract Area at the Annual rate of TEN PESOS ($10.00) per hectare.

8.3 Share of the Government - The share of the Government shall be as follows:

a) Basic Share - There shall be a basic share due to the Government of FIVE PERCENT (5%) of the Gross Revenue.

b) Share in Net Revenue - From the start of Commercial Production, the Government shall be entitled to a TEN PERCENT (10%) share of the Net "Mining Revenue".

8.4 Pricing of Sales - The Contractor shall endeavor to obtain the best achievable price for its products and pay the lowest achievable marketing commission and related fees. The Contractor shall seek to strike a balance between long-term and short-term sales comparable to policies followed by independent producers in the international mining industry.

8.5 Associated Minerals - All minerals other than those discovered in commercial quantities in the Contract Area, the value thereof shall be added to the value of the principal mineral in computing the share of the Government.
9.1 Submission to Government - Within the periods stated herein, the Contractor shall prepare and submit to the Government the Work Program and Budget for the Contract Area stating the Mining Operations which Contractor proposes to carry out during the period covered with the details and particulars set forth in this Agreement or in the Guidelines (DENR Administrative Order No. 57 series of 1989).

9.2 Examination, Revision - Should the Government wish to propose a revision as to certain specific features of said Work Program or Budget, it shall do within thirty (30) days after receipt thereof. Notice to Contractor specifying in reasonable detail its reasons therefore. Promptly thereafter, the Government and Contractor will meet and endeavor to agree on the revision proposed by the government. In any event any portion of said Work Program or Budget as to which the Government shall fail to notify Contractor of proposed revision shall, insofar as possible, be carried out as prescribed herein. If the Government shall fail within sixty (60) days from receipt thereof to notify Contractor of proposed revisions, the Work Program and Budget proposed by Contractor shall be deemed to be approved.

9.3 It is recognized by the Government and Contractor that the details of any Work Programs may require changes in the light of changing circumstances. The Contractor may make such changes provided they do not change the general objective of any Work Program, and provided further, that changes which will change the percentage of any such change in the Work Program be subject to the approval of the Secretary.

9.4 The Government's approval of a proposed Work Program and Budget will not be unreasonably withheld.

SECTION X

RIGHTS AND OBLIGATIONS OF THE PARTIES

10.1 Obligations of the Contractor

The Contractor shall:

a) Perform all Mining Operations in accordance with the most efficient and internationally accepted mining and engineering practices providing all necessary services, technology and financing in connection therewith;

b) After the Exploration Period, the Contractor shall relinquish to the Government within three (3) months which shall not be necessary for Mining Operations and not covered by any Declaration of Mining Feasibility.

c) Perform its activities within the periods expressed in this Agreement. Plans and Work Programs, save as may be excused by Force Majeure.

d) Furnish all materials, labor, equipment, and other installations that may be required for carrying out all Mining Operations. To the extent technically feasible, the Contractor shall give preference to products and services produced and offered in the Philippines.

In the Philippines, the Contractor shall give preferential consideration to Filipino construction enterprises and use buildings and equipment available in the Philippines, employing Filipino contractors and transportation and purchasing Filipino household equipment. Furniture and supplies shall be made in accordance with the terms and conditions of this Agreement.

e) The Contractor shall, to the extent feasible and acceptable in view of the rates and conditions available, maximize the use of Filipino vessels and other means of transport available in the Philippines. If necessary, the Contractor shall set joint arrangements with Filipino concern for the transportation of concentrates.

f) The Contractor shall keep accurate technical records about the operations, as well as financial and marketing accounts, and make them available to the Authority for purposes of assessing performance and compliance of the Contractor with terms of this Agreement.

Authorized representatives of other Government agencies may also have access to such accounts in accordance with existing laws and regulations.

g) Hold the Government free and harmless from all claims and accounts of all kinds, as well as demands and action arising out of the accidents or injuries to persons or property caused by Mining Operations of the Contractor and indemnify the Government for any expenses or cost incurred by the Government by reason of any such claims, accounts, demands or actions.

h) Pay taxes or obligations in accordance with existing laws, rules and regulations.

i) Conform to laws and regulations regarding, among others, labor, safety, demarcation of the Contract Area, and non-interference with the rights of other mining operators.

j) Allow access to exploration and production sites and operations by inspectors authorized by the Government.

k) Recognize and respect the rights, customs and traditions of indigenous tribal communities over their ancestral lands.

l) Contribute to national development by helping develop the local economy, industry and transport in the Contract Area, the Philippines, and mining technology, and mitigating environmental effects of Mining...
1-1) Development of Host and Neighboring Communities:

(a) The Contractor shall coordinate with proper authorities in providing development plans for the host and neighboring communities.

(b) The Contractor shall help create self-sustaining, income-generating activities, such as but not limited to, reforestation and production of goods and services needed by the mine.

(c) The Contractor shall give preference to Filipino citizens, particularly residents of the host and neighboring communities in hiring personnel for its Mining Operations. If necessary skills and expertise are currently not available, the Contractor must prepare and undertake a training and recruitment program within the first year of Commercial Production at its expense.

1-11) Development of Geosciences and Mineral Technology:

(a) The Contractor, in the course of its operations, shall produce geological, geophysical, geochemical and other types of maps and reports in scales, format, and nomenclature consistent with internationally accepted geoscience and standards.

(b) The Contractor shall systematically keep the data generated from the Contract Area such as, geophysical, geochemical and other related information, including economic and financial data and shall make them accessible to the researches and other persons responsible for developing geosciences and mineral technology after declassification.

1-111) Environment Protection and Mineral Safety:

(a) The Contractor shall prepare a plan of mining so that its damage to the environment will be minimal. To the extent possible, control of pollution and the transformation of the mined-cuts areas or areas economically and socially active forms must be done simultaneously with mining.

An Initial Environmental Examination (INEE) shall be required as part of the exploration program and appropriate Environment Impact Statement (EIS) shall be required component of any of the feasibility studies of the mine, and shall be prepared in form prescribed by proper government authorities.

19.2 Rights of the Contractor:

The Contractor shall:

a) Have the right to conduct Mining Operations in the Contract Area in accordance with the terms and conditions hereof.

b) Have the right of possession of the Contract Area, with full right of ingress and egress and the right to occupy the same, subject to surface easements.

c) Have the right to use and have access to all declassified geological, geophysical, drilling production and other information held by the Government or any Agency or enterprise thereon now or in the future, relating to the Contract Area.

d) Have the right to sell, assign, transfer, convey or otherwise dispose of all its rights, interests and obligations under this Agreement subject to the approval of the Government.

e) Subject to applicable laws and regulations, to employ or bring into the Philippines foreign technical and specialized personnel (including the immediate families) as may be required in the operations of the Contractor; provided that if the employment connection of such foreign person with the Contractor ceases, the applicable laws and regulations on immigration shall apply to them.

f) Enjoy, subject to pertinent laws, rules and regulations and the rights of third parties, cession rights, and the use of timber, water and other natural resources in the Contract Area.

g) Have the right of reparation of capital and remittance of profits, dividends and interest on loans subject to existing laws, and Central Bank rules and regulations and

h) Have the right to import when necessary all equip-
10.3 Obligations of the Government

The Government shall:

a) Ensure that Contractor has the Government's full cooperation in the exercise of the rights granted it under this Agreement;

b) Use its best efforts to ensure the timely issuance of necessary permits and similar authorizing documents for use of surface of the Contract Area;

c) If Contractor seeks to obtain financing contemplated herein from banks or other financial institutions, cooperate with Contractor in such efforts provided that such financing arrangements will in no event reduce Contractor's obligation or the Government's rights hereunder.

SECTION XI

ASSETS AND EQUIPMENT

11.1 Contractor shall acquire for the Mining Operations only such assets as are reasonably estimated to be required in carrying out such Mining Operations.

11.2 All materials, equipment, plant and other installations erected or placed on the Contract Area of a movable nature by the Contractor and the Contractor shall have the right to remove the export such materials, equipment, plant and other installations from the Philippines, subject to existing laws and regulations.

Further, such materials, equipment, plants and other installations shall be removed from the Contract Area within twelve (12) months from the termination of the Agreement, otherwise they will be forfeited in favor of the Government.

SECTION XII

EMPLOYMENT AND TRAINING OF FILIPINO PERSONNEL

12.1 The Contractor agrees to employ, to the extent possible, qualified Filipino personnel in its Mining Operations; and after Commercial Production commences 'shall', in consultation with the consent of the Government, elaborate an extensive training program for employment of suitable Filipino nationals at all levels of employment. The objective of the said program shall be to reach within the time-table set forth below the following targets of "Filipinization":

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<thead>
<tr>
<th>Year</th>
<th>Unskilled</th>
<th>Skilled</th>
<th>Clerical</th>
<th>Professional</th>
<th>Management</th>
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<tbody>
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<td>50%</td>
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</tbody>
</table>

12.2 Cost and expenses of training such Filipino personnel and the contractors own employees shall be included in Operating expenses.

SECTION XIII

ARBITRATION

13.1 The Government and the Contractor shall consult with each other in good faith and shall exhaust all available remedies to settle any and all disputes or disagreements arising out of or relating to the validity, interpretations, enforceability, or performance of this Agreement before resorting to arbitration.

13.2 Any disagreement or dispute which cannot be solved amicably shall be settled by a tribunal of three (3) arbitrators, one to be appointed by the Contractor, another to be appointed by the Government, and the third by the arbitrators so appointed who shall serve as Chairman. The first two appointed arbitrators shall continue to consider names of qualified persons until agreement on a mutually acceptable Chairman of the tribunal is reached. Such arbitration shall be initiated and conducted pursuant to Republic Act No. 676 otherwise known as the Arbitration Act.

Where substantial foreign interests are involved, the Contractor may elect within thirty (30) days from Effective Date arbitrations accordance with the rules of Conciliation and Arbitration of the International Chamber of Commerce ('ICC'), provided that in any case where the ICC or its successor is not in existence, the arbitration shall proceed in accordance with the Uniform (United Nations Commission for International Trade Law) Arbitration Rules, as the present in force.

In any event, the arbitration shall be conducted applying the substantive law of the Republic of the Philippines.

13.3 Each party shall pay fifty percent (50%) of the fees and expenses of the arbitrators and the costs of arbitration. Each party shall pay its own costs and expenses.

SECTION XIV

TERMINATION
This Contract shall be terminated and the Parties shall be relieved of their respective obligations:

14.1 On expiration of the term, or extension thereof as provided elsewhere herein.

14.2 Termination by the Government upon the Contractor's substantial breach of this Agreement.

14.3 By withdrawal of Contractor. The Contractor may withdraw from this Agreement by giving six (6) months notice in writing if in its business judgment the continuation of operations becomes technically or economically unfeasible. The withdrawal shall become effective six (6) months after notice of withdrawal has been received by the Government.

No delay or omission on the part of the Government shall impair any of its rights hereunder except for a written waiver. The Government's right to seek recourse and relief by all other means shall not be affected by the exercise of its right to terminate the Agreement. Any waiver of default shall not be construed to be a waiver of any succeeding or other default unless the contrary is expressly stated in writing signed by the party charged with the waiver.

In case of termination, the Contractor shall pay all fees and other liabilities due up to the end of the year in which the termination becomes effective, and shall further carry out such restoration of the Contract Area as is reasonable in accordance with good mining industry practice.

SECTION XV

OTHER PROVISIONS

15.1 Notice

All notices, demands, and other communications required or permitted hereunder shall be made in writing or by telegraph or telecopy and shall be deemed to have been duly given in the case of telegraph or telecopy notice if answered back or confirmation received, or if delivered by hand upon receipt or ten days after being deposited in the mail, airmail postage prepaid and addressed as follows:

If to the Government:
The Secretary of the Department of Environment and Natural Resources
DENR Building, Visayas Avenue
Diliman, Quezon City

If to the Contractor:

Either party may substitute or change such address.

on Notice thereof to the other Party.

15.2 Governing Law

This Agreement and the relation between the Parties hereto shall be governed by and construed in accordance with laws of the Republic of the Philippines.

15.3 Suspension of Obligation

a) Any failure or delay on the part of any Party in the performance of its obligations or duties hereunder shall be excused to the extent attributable to Force Majeure.

b) If Mining Operations are delayed, curtailed or prevented by such Force Majeure causes, then the time for enjoying the rights and carrying out the obligations thereby affected, the term of this Agreement and all rights and obligations hereunder shall be extended for a period equal to the period thus involved.

c) The Party whose ability to perform its obligation is affected (I) shall promptly give Notice to the other in writing of any such delay or failure in performance, the expected duration thereof, and its anticipated effect on the Party expected to perform, and (II) shall use its efforts to remedy such delay, except that neither Party shall be under any obligation to settle a labor dispute.

15.4 Amendments

This Agreement shall not be amended, modified in any respect except by mutual consent in writing of the Parties hereto.

15.5 The Contractor shall cause the Registration of this agreement to the DENR Regional Office concerned within thirty (30) calendar days from date of execution.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement as of day and year first above written.

THE REPUBLIC OF THE PHILIPPINES

BY:

FULGARDO S. FACTORAN, JR.
Secretary
Department of Environment and Natural Resources

MINING COMPANY

SIGNED IN THE PRESENCE OF:
ACKNOWLEDGEMENT

REPUBLIC OF THE PHILIPPINES
CITY OF __________  1.B.S.

BEFORE ME, a Notary Public, for and in the City of ________, Philippines, personally appeared FULGENCIO S. FACTORAN, JR., with Residence Certificate No. __________, issued on __________, in his Capacity as Secretary of Environment and Natural Resources and __________, issued on __________, in his Capacity as President of __________, both known to me and to be known to be same persons who executed the foregoing agreement consisting of Twenty (20) pages and acknowledge to me that the same is their free and voluntary acts and deed of entities herein represented.

IN WITNESS WHEREOF, I have hereunto signed these presents and affixed my notarial seal this __________ day of __________, 1991.

______________________________
NOTARY PUBLIC

Doc. No. _______________________
Page No. _______________________  
Book No. _______________________ 
Series of 19 __________