



Shareholder Protection for Investing in the Philippine LNG industry and FSRUs

Mark Tudor, Hiroyasu Konno, Yoshiaki Otsuki, Jun Katsube, Michelle Marie F. Villarica

Background

The Philippines is a country with a current population of approximately 100 million and a steadily growing economy. With more than 7,600 islands, nationwide distribution of power is difficult and expensive. In fact, many of the smaller Philippine islands are powered by diesel generators and frequently suffer blackouts.

The Philippine Department of Energy (“DOE”) anticipates that the country’s demand for energy will triple by 2040 and considers that the country needs a cheaper, more efficient, and more secure source of power. To address this issue, the DOE is focusing on diversifying its energy resources particularly through the development of its natural gas industry. Currently, the Malampaya gas field is the only productive gas field in the country, and about 98% of its production is currently used for power generation, however, projections show that this field will likely deplete within the next 10 years.

Government Policy

The DOE has released a draft circular on the implementing guidelines of the Philippines Natural Gas Regulation (“Regulation”) which will govern the entry and development of liquefied natural gas (“LNG”) in the Philippines. On 10 October 2017, the DOE commenced a public consultation encouraging the public to comment and provide suggestions for a more comprehensive Regulation.

Aside from meeting the country’s LNG requirements, the DOE also sees an opportunity to become the LNG trading and

This newsletter is the product of its authors and does not reflect the views or opinion of Nishimura & Asahi. In addition, this newsletter is not intended to create an attorney-client relationship or to be legal advice and should not be considered to be a substitute for legal advice. Individual legal and factual circumstances should be taken into consideration in consultation with professional counsel prior to taking any action related to the subject matter of this newsletter.

transshipment hub of Southeast Asia. Among other objectives, the Regulation seeks to spearhead the implementation of policies and programs on the importation of LNG for local and foreign demand.¹

The emerging LNG market in the Philippines is a good opportunity for investment and the country is looking to the international community for support. Nevertheless, the Philippines still maintains laws that restrict foreign ownership of corporations in particular industries.

FSRU

One potential solution to the demand for increased, low cost power generation and the increased use of natural gas is the use of floating storage and regasification units (“FSRU”) to import LNG. However, for foreign investors there are certain requirements for the use of FSRU which need to be considered in the planning stages. Current Philippine Maritime Industry regulations require a foreign registered FSRU to obtain a special permit to operate within Philippine waters.² These special permits are only granted to accredited Philippine nationals, wholly Philippine owned partnerships, or corporations with at least 60% Philippine owned equity. This means that a non-Filipino company or person can only acquire a minority ownership interest of up to 40% in the FSRU. Accordingly, in the absence of a change in law to permit majority ownership by non-Philippine nationals, a significant concern for foreign investors is whether they are able to sufficiently protect their investment.

As the intention of the regulations is to promote equity ownership of vessels by Philippine nationals these provisions cannot be avoided by the use of “nominee structures” in which the foreign investor controls the FSRU despite being a minority shareholder. Accordingly, foreign investors need to consider other ways to protect their minority interest in the FSRU company.

Existing Minority Protections

Minority investors in the Philippines have various protections under the Philippine Corporation Code (“Code”):

1. **Shareholders Voting Right**

Under Philippine law, a minority shareholder holding at least 33.33% is entitled to certain veto rights which relate to fundamental corporate matters such as: the sale of all or substantially all of the assets of the corporation; amendment of the articles of incorporation and by-laws; increase or decrease in capital stock; merger or consolidation; dissolution; and removal of directors.

2. **Representation in the Board of Directors**

The Code mandates the use of cumulative voting in the election of directors so that the minority can ensure representation on the board of directors by concentrating their cumulative votes on at least one candidate. Often, the shareholders’ agreement will stipulate the right of the shareholders to appoint their respective representatives to the board of directors. In accordance however with the Philippine Anti-Dummy Act, the number of non-Philippine nationals in the board of directors must be in proportion to their allowable foreign participation in such entity.³ This requirement is intended to

¹ Draft Rules and Regulations Governing the Philippine Natural Gas Industry, Rule I, Section 2(2).

² Maritime Industry Authority, Marina Circular No. 2017-02, Part IV (2).

³ The Anti-Dummy Law, as amended § 1 (1975).

prevent shareholders from indirectly circumventing the nationality restriction under Philippine law and allowing non-Philippine nationals to manage and control (through the board of directors) corporations engaged in partially nationalized industries. Thus, in a corporation, such as an FSRU owner, in which the maximum permitted foreign ownership is 40%, only 2 out of 5 directors may be foreign nationals. Although directors may be removed with or without cause, the Code prohibits the removal of directors without cause if it will deny minority shareholders representation on the board.

To further protect their interests, the shareholders can stipulate in the shareholders' agreement that certain matters will require the affirmative vote of a minority director provided that these matters are not deemed as granting the foreign shareholders effective control over the corporation, in breach of foreign investment restrictions. This means that a director representing a foreign minority shareholder cannot be granted veto rights for issues involving the management of the company. A shareholders' agreement however may contain a stipulation that matters such as material acquisitions and disposals beyond an agreed threshold, material changes in the business, amendment of the constitutional documents of the corporation, increase or decrease in the authorized capital stock, entering into related party transactions, change in dividend policy, and other matters that do not govern the financial and operating policies of the entity are subject to the affirmative vote of the directors appointed by the minority shareholders.

3. Pre-emptive Right

Unless the right is specifically denied in the articles of incorporation, all stockholders are granted pre-emptive rights. This right allows a shareholder to subscribe to all issues or dispositions of shares in proportion to his present stockholdings so that the shareholder can maintain his proportionate control in the corporation, retain his equity in the retained earnings and in the net assets in the event of dissolution.

4. Power of Inspection

Philippine law requires a corporation to allow shareholders to inspect its corporate books and records of all business transactions including minutes of board meetings, book of inventories and balances, journals, ledgers, financial statements, income tax returns, vouchers, receipts, and contracts. Shareholders are required to exercise this right in good faith and for a legitimate purpose.

5. Right to Dividends

Dividends can be declared only out of the unrestricted retained earnings of the corporation, subject to the discretion of the board of directors. A corporation however is prohibited from retaining surplus profits in excess of 100% of its paid-in capital stock. When this occurs, the Securities and Exchange Commission may direct the corporation to declare dividends, except:

- a) when such retention is justified by definite corporate expansion projects or programs approved by the Board;
- b) when the corporation is prohibited under any loan agreement with any financial institution or creditor, whether local or foreign, from declaring dividends without its consent, and such consent has not been secured; or
- c) when it can be clearly shown that such retention is necessary under special circumstances, such as when there is a need to maintain a special reserve for probable contingencies.

6. Appraisal Right

An appraisal right is a stockholder's right to dissent and demand payment of the fair value of his shares. This right is available in any of the following transactions:

- a) Where any amendment to the articles of incorporation has the effect of changing or restricting the rights of any

stockholders or class of shares, or of authorizing preferences in any respect superior to those of outstanding shares of any class, or of extending or shortening the term of corporate existence;

- b) Where there is any sale, lease, exchange, transfer, mortgage, pledge or other disposition of all or substantially all of the corporate property and assets as provided in the Code;
- c) In case of merger or consolidation; or
- d) In case of an equity investment in a business enterprise outside the scope of the primary purpose of the corporation, as specified in its articles of incorporation.

A stockholder can exercise this right after he has voted against the proposed corporate action by making a written demand on the corporation within 30 days after the date on which the vote was taken. If the proposed corporate action is implemented or affected, the corporation shall pay to such stockholder the fair value of the shares as of the day prior to the date on which the vote was taken.

7. **Other Protections**

In addition to the above protections, minority shareholders should also ensure in the joint venture documentation (eg shareholders' agreement) that they have an exit strategy in the event they wish to dispose of their shares in the corporation. The following rights are usually included to protect minority shareholders when they wish to sell their shares:

a) Tag along rights

This right assures that if the majority shareholder sells its shares in the corporation, minority shareholders can join the sale and sell their shares under the same terms and conditions as that of the majority shareholder.

b) Put Option

A put option will give a shareholder the right to require the other shareholders to purchase his shares. The shareholders can stipulate a particular time or trigger event for this right. The put option should state the amount of shares that can be bought or sold and the share price or a valuation method for the price of the shares.

Conclusion

The Philippines' determination to develop its natural gas industry is apparent. To achieve this goal, there is a strong interest in securing international investments. In his keynote address during the 3rd LNG Supply, Storage and Transport Philippines Forum in 2016, Undersecretary Ben Ranque expressed that the Philippines definitely and most urgently needs substantial investments in its LNG infrastructure development, especially in the plan to build a common receiving and distribution infrastructure as part of the future "clean energy city" in the country.

With the right strategy and mechanisms in place, foreign investors can invest in and benefit from the Philippine Government's wish to expand the gas and electricity markets in the Philippines.



[Mark Tudor](#)

Partner (Foreign Law Partner*)

E-mail: m_tudor@jurists.co.jp

Mark Tudor joined Nishimura & Asahi in May 2016 and has over 18 years experience advising in the energy and natural resources (with 10 of those years being in Japan with an international law firm). Most recently he worked for an FPSO and engineering contractor and has experience advising on onshore and offshore FEED, EPC and other engineering and construction contracts and on development of oil, gas and LNG projects.

*Please note that we are not engaged in a Gaikokuho Kyodo Jigyo (the operation of a foreign law joint enterprise).



[Hiroyasu Konno](#)

Attorney-at-Law

E-mail: h_konno@jurists.co.jp

Hiroyasu Konno advises clients on various matters of energy and natural resources transactions, such as LNG SPAs, oil upstream projects and metal mining projects. Currently he is a member of EU-Japan LNG expert and stakeholder meeting.



[Yoshiaki Otsuki](#)

Attorney-at-Law

E-mail: y_otsuki@jurists.co.jp

Yoshiaki Otsuki joined Nishimura & Asahi in 2004 after graduating University of Tokyo and admitted in Japan in 2004. He mastered L.L.M of University of Southern California Gould School of Law in 2011 and was admitted in New York in 2012. He worked for Nippon Steel & Sumitomo Metal Corporation from 2012 to 2014. He is now seconded to Japan Oil, Gas and Metals National Corporation (JOGMEC). Recently he has been involved in LNG development and its procurement projects for Japanese clients.



[Jun Katsube](#)

Attorney-at-Law

E-mail: j_katsube@jurists.co.jp

Jun Katsube joined Nishimura & Asahi in 2006. He mastered L.L.M of University of Southern California Gould School of Law in 2013 and was admitted in New York in 2014 and California in 2017. He worked for the legal department of Mitsui & Co. from 2014 to 2016 where he dealt with various energy and natural resources projects in South East Asia region. Recently he has been working for LNG development, mining and FPSO projects.



**[Michelle Marie F.
Villarica](#)**

Foreign Attorney

E-mail: michelle.villarica@jurists.jp

Michelle Marie F. Villarica joined Nishimura & Asahi in 2017. She graduated from the Ateneo de Manila University School of Law in Manila, Philippines in 2011 and was admitted to the Philippine bar in 2012. In 2016, she obtained her LL.M. from the University of Edinburgh in Scotland, United Kingdom and registered as a foreign lawyer in Singapore in 2017. Prior to joining Nishimura & Asahi, Michelle worked for a Philippine law firm in Manila, Philippines and among others, assisted clients in the oil and gas sector. Her work currently focuses on mergers & acquisitions, joint ventures, and general corporate law.