



Republic of the Philippines
Department of Finance
Securities and Exchange Commission
SEC Building, EDSA, Greenhills, Mandaluyong City
Office of the General Counsel

December 05, 2013

SEC-OGC Opinion No. 13-13
Re: Proprietary Shares; Vested Rights;
Registration of Securities

MR. JERIC HECHANOVA

General Manager
Cebu Country Club, Inc.
P.O. Box 698, Banilad
Cebu City, 6000

Dear Mr. Hechanova,

This refers to your letter dated 25 October 2013 amending and consolidating your initial queries stated in your letter of 27 December 2012.

In your 27 December 2012 letter, you mentioned that Cebu Country Club, Inc. ("CCCI") is a membership, non-stock corporation formed, among others, to maintain, operate, manage and carry on a social and recreation club in the City and Province of Cebu for the amusement, entertainment, instruction, recreation and refreshment of its members, and such others as may be designated in the by-laws of the corporation. You further stated that CCCI is considering of amending its Articles of Incorporation to increase the number of Proprietary Ownership Certificates ("POCs") it can issue from the present Eight Hundred (800) certificates to a higher number which is to be decided by the members. Thus, you requested for an opinion on the following queries:

- a. Will the voting be limited to the 100 voting members only?
- b. Will the voting have to include all members of the CCCI who are holders/owners of POC? Or
- c. Will the voting have to be for all POC owners whether members or not?
- d. Assuming that CCCI decides to issue 120 new and additional POCs, on top of its already existing and issued 800 POCs, the purpose of which is to sell

them to members only, not to the public, and the proceeds thereof to be used to renovate its existing Club House with additional buildings and to remodel its existing golf course, can CCCI be exempted from registration of securities for these 120 new POCs?

However, in your 25 October 2013 letter, you amended your earlier request due to the following reasons, to wit:

- a. The Board of Directors of CCCI ("Board") was planning to propose to its members to renovate the club. The Board was also considering to increase the number of Proprietary Ownership Certificates ("POCs") from its current limit of 800 certificates as an option to fund the project;
- b. On March 8, 2013, the voting members of the club approved the plan to renovate its clubhouse and golf course. The Board was then given the authority to pursue the renovation project and to do and perform all acts necessary for such purpose. It was also approved that a special assessment would be imposed on the members of the club in order to fund the project.
- c. The Board was further given the authority to look for other options to fund the project and presently, the option being looked into is the lease of a portion of the club to a real estate developer.
- d. However, during the March 8, 2013 meeting, one of the members raised the issue of vested rights and co-ownership of the properties of the club of its members.

Accordingly, you now seek our opinion on the following consolidated and amended issues:

- a. If the club amend its Articles of Incorporation by issuing new POCs, the purpose of which is to fund the renovation project, will the voting be limited only to the 100 voting proprietary members; or to all the 800 POC holders of CCCI?
- b. If the club enters into a long-term lease of a portion of its property, does the Board of Directors, by itself, have the opportunity to enter into such an agreement or does it need the approval of the 100 voting proprietary members; or does it need to be ratified by all the 800 members?

- c. Are the owners of POCs "co-owners" of the Corporation, thereby, giving them vested rights?

Please be advised that pursuant to SEC Memorandum Circular No. 15, Series of 2003, the Commission refrains from rendering an opinion on the matter stated in your first query involving as it does the substantial and contractual rights of the private parties who would, in all probability, contest the same in court if the opinion turns out to be adverse to their interest. Such is the nature of your first query which involves voting rights that are litigious in nature and may thereafter lead to an intra-corporate issue, jurisdiction over which is already transferred to the Regional Trial Courts, pursuant to Section 5.2 of the Securities and Regulation Code ("SRC"). However, for purposes of information only, the following are imparted.

As to your first query, it is important to note that in a previous Opinion dated 12 January 1988¹ issued to CCCI and addressed to Mr. Julius Z. Neri, the Commission categorically answered the same question, *viz*:

"The pertinent provision of Section 89 of the Corporation Code, is quoted hereunder:

Sec. 89. *Right to Vote.* – The right of the members of any class or classes to vote may be limited, broadened or denied to the extent specified in the articles of incorporation or the by-laws. Unless so limited, broadened or denied, each member, regardless of class, shall be entitled to one vote.

From the foregoing provision therefore it is clear that the articles of incorporation or the by-laws may limit, broaden or even deny a member's right to vote.

Sections 1 and 2 of Article III of your approved Amended By-laws provide(s), and we quote:

Section 1. *Persons Exercising Voting Rights.* – All present full resident members of the Cebu Country Club, Inc. each of whom has elected to purchase a Proprietary Ownership Certificate

¹ When Republic Act No. 8799 otherwise known as the Securities and Regulation Code and SEC Memorandum Circular No. 15, Series of 2003 did not yet exist.

and to pay for the same within the period allowed therefor, shall be entitled to one vote in all affairs of the corporation and shall be designated as a "Voting Proprietary Member."

Section 2. How Voting Rights are Acquired. – By a unanimous approval of the Board, any proprietary member may be elected as and given the status of a voting proprietary member provided that at no time shall the number of voting proprietary members exceed one hundred (100) and provided further, that in no case shall the number of voting members who are not citizens of the Philippines exceed FORTY (40) percent of the total voting proprietary membership.

From the above, there is no doubt that the right to vote in your corporation is limited to the Voting Proprietary members in accordance with the aforequoted provisions of your by-laws. Consequently, only such voting proprietary members shall be allowed to vote in the amendment of the club's articles of incorporation."

With regard to your second query, we find reference to Section 40 of the Corporation Code which reads:

"Sec. 40. Sale or other disposition of assets. - Subject to the provisions of existing laws on illegal combinations and monopolies, a corporation may, by a majority vote of its board of directors or trustees, **sell, lease, exchange, mortgage, pledge or otherwise dispose of all or substantially all²** of its property and assets, including its goodwill, upon such terms and conditions and for such consideration, which may be money, stocks, bonds or other instruments for the payment of money or other property or consideration, as its board of directors or trustees may deem expedient, **when authorized by the vote of the stockholders representing at least two-thirds (2/3) of the outstanding capital stock, or in case of non-stock corporation, by the vote of at least two-thirds (2/3) of the members, in a stockholder's or member's meeting duly called for the purpose.**³ xxx

A sale or other disposition shall be deemed to cover substantially all the corporate property and assets if thereby the

² Emphasis ours.

³ Emphasis ours.

corporation would be rendered incapable of continuing the business or accomplishing the purpose for which it was incorporated⁴. xxx"

However, the Commission in its 21 October 2002 Opinion addressed to Sycip, Salazar Hernandez and Gatmaitan explained that:

"Section 40 (par. 2 thereof) of the Corporation Code defines the term 'sale or disposition of all or substantially all the assets' as one which will render the corporation incapable of continuing the business or accomplishing the purposes for which it was incorporated. Section 40 of the Code applies only if after the disposition of corporate assets, the disposing corporation can no longer continue the business for which it was organized or accomplish the purpose for which it was incorporated. (Lopez, Corporation Code, p. 571) In other words, if after the disposition of corporate assets, the disposing corporation can still continue the business for which it is organized, the disposition can be made without complying with the requirements set forth in the aforementioned provision as it is not covered by said section. (SEC Opinion dtd. February 16, 1987, citing Agbayani, Commercial Laws, Vol. 3, p. 355)

In interpreting paragraph 2 of Section 40, this Commission has been guided not so much by the number or volume of the assets transferred but by the effect of such transfer on the corporation's business. **Any disposition which does not involve all or substantially all of the corporate assets as defined above, made in the ordinary course of business does not require the approval of the stockholders or members⁵ . . .** To determine if the sale is made in the ordinary course of business, the test is not the amount involved but the nature of the transaction. (De Leon, Corporation Code, 1993 edition, p. 316) Hence, if the sale thereof will not render the corporation incapable of continuing its business or if the disposition is necessary in the usual and regular course of business, the board of directors as it may deem expedient and in good faith, dispose the same without the approval of the stockholders. (SEC Opinion dtd. August 21, 1995, RP Enterprises Inc.)"

Finally, as to your third query, please note that we abide by the long-entrenched doctrine of separate juridical personality of a corporation. By virtue of which, law and equity provides that a corporation is a distinct legal entity to be

⁴ Emphasis ours.

⁵ Emphasis ours.

considered as separate and apart from the individual stockholders or members who compose it, and thus, a corporation is not affected by the personal rights, obligations and transactions of its stockholders or members. Consequently, the property of the corporation is its property and not that of the stockholders or members as owners, although to a certain extent, stockholders have equities in it.⁶ This means that the stockholders or members merely have inchoate rights over the corporate assets, and that until the corporation is dissolved and its assets are applied and distributed in accordance with the law i.e., Section 94⁷ or 95⁸ of the Corporation Code, no stockholder or member could claim ownership or interest of any of the specific properties owned by the corporation.

This is further bolstered by the definition of a Proprietary Share or Certificate in the Amended Implementing Rules and Regulation of the Securities and Regulation Code, to wit:

"Proprietary share or certificate is an evidence of interest or participation or privilege in a corporation which not only entitles the holder to enjoy the use

⁶ *Sulo ng Bayan v. Araneta*, G.R. No. L-31061, 17 August 1976.

⁷ Sec. 94. *Rules of distribution.* - In case dissolution of a non-stock corporation in accordance with the provisions of this Code, its assets shall be applied and distributed as follows: 1. All liabilities and obligations of the corporation shall be paid, satisfied and discharged, or adequate provision shall be made therefore; 2. Assets held by the corporation upon a condition requiring return, transfer or conveyance, and which condition occurs by reason of the dissolution, shall be returned, transferred or conveyed in accordance with such requirements; 3. Assets received and held by the corporation subject to limitations permitting their use only for charitable, religious, benevolent, educational or similar purposes, but not held upon a condition requiring return, transfer or conveyance by reason of the dissolution, shall be transferred or conveyed to one or more corporations, societies or organizations engaged in activities in the Philippines substantially similar to those of the dissolving corporation according to a plan of distribution adopted pursuant to this Chapter; 4. Assets other than those mentioned in the preceding paragraphs, if any, shall be distributed in accordance with the provisions of the articles of incorporation or the by-laws, to the extent that the articles of incorporation or the by-laws, determine the distributive rights of members, or any class or classes of members, or provide for distribution; and 5. In any other case, assets may be distributed to such persons, societies, organizations or corporations, whether or not organized for profit, as may be specified in a plan of distribution adopted pursuant to this Chapter.

⁸ Sec. 95. *Plan of distribution of assets.* - A plan providing for the distribution of assets, not inconsistent with the provisions of this Title, may be adopted by a non-stock corporation in the process of dissolution in the following manner: The board of trustees shall, by majority vote, adopt a resolution recommending a plan of distribution and directing the submission thereof to a vote at a regular or special meeting of members having voting rights. Written notice setting forth the proposed plan of distribution or a summary thereof and the date, time and place of such meeting shall be given to each member entitled to vote, within the time and in the manner provided in this Code for the giving of notice of meetings to members. Such plan of distribution shall be adopted upon approval of at least two-thirds (2/3) of the members having voting rights present or represented by proxy at such meeting.

of a specific property but also to dividends or earnings of said company. Upon liquidation of the company, a holder of a proprietary share shall have proportionate ownership right over its assets.”⁹

Thus, while stockholders merely have inchoate rights over the properties of the corporation, they do have certain rights such as pre-emptive rights or the privilege to subscribe to all issues or disposition of shares of any class, in proportion to their respective shareholdings before the same is offered to the general public.¹⁰ However, stockholders may be denied of their pre-emptive rights if such denial is permitted by the Articles of Incorporation.¹¹ An example of such denial is Section 9 of your Articles of Incorporation as mentioned in your 06 March 2013 follow-up letter.

On another note, although the 4th query stated in your 27 December 2012 letter in relation to the exemption from registration of additional POCs is not included in your consolidated and amended issues, the Commission deems it best to answer the same.

We invite your attention to Section 10.1 of the SRC pertaining to exempt transactions, especially paragraphs (e)¹², (i)¹³ and (j)¹⁴. In this regard, please take note of the conditions for each exempt transaction in order to be exempted from registration.

We also invite your attention to Section 10.1 Paragraph 3.A. of the Amended Implementing Rules and Regulation of the SRC which provides:

⁹ SRC Rule 3 – Definition of Terms Used in the Rules and Regulations.

¹⁰ Section 39, Corporation Code.

¹¹ *Ibid.*

¹² The sale of capital stock of a corporation to its own stockholders exclusively, where no commission or other remuneration is paid or given directly or indirectly in connection with the sale of such capital stock.

¹³ Subscriptions for shares of the capital stock of a corporation prior to the incorporation thereof or in pursuance of an increase in its authorized capital stock under the Corporation Code, when no expense is incurred, or no commission, compensation or remuneration is paid or given in connection with the sale or disposition of such securities, and only when the purpose for soliciting, giving or taking of such subscription is to comply with the requirements of such law as to the percentage of the capital stock of a corporation which should be subscribed before it can be registered and duly incorporated, or its authorized capital stock increased.

¹⁴ The sale of securities by an issuer to fewer than twenty (20) persons in the Philippines during any twelve-month period”

"3. Exempt Transactions Requiring Notice

- A. Notice of exemption on SEC Form 10-1 shall be required in an offering or distribution of securities under Section 10.1 (k) and (l) of the Code."

Consequently, if the offering or distribution of your increased POCs falls within the conditions specified in Section 10.1 (e) or (i), a notice of exemption is not required. However, if the offering or distribution of such increased POCs falls in Section 10.1 (k), a notice of exemption from the registration requirements on SEC Form 10-1 must be filed with the Corporate Governance and Finance Department ("CGFD") of the Commission.

In any case, whether or not a notice is required, you may opt to file with our CGFD an application for confirmation or declaration of exemption, also through SEC Form 10-1, pursuant to Section 10.3¹⁵ of the SRC.

Unless confirmation of the availability of such exemption is applied for, any person claiming an exemption under Section 10 has the burden, if challenged, to establish that the exemption is available and the Commission may challenge such exemption at any time.¹⁶ This means that although an application for confirmation is optional, a party may avail of such confirmation to defeat future challenge from the Commission.

On a final note, if the offering or distribution of your increased POCs does not fall in any of the exempt transactions provided in Section 10.1 of the SRC, you may still request for an exemption from the Commission, pursuant to Section 10.2 of the SRC, by providing justifications that the requirements of registration under the SRC is not necessary in the public interest or for the protection of the investors such as by reason of the small amount involved or the limited character of the public offering.

¹⁵ Any person applying for an exemption under this section, shall file with the Commission a notice identifying the exemption relied upon on such form and at such time as the Commission by rule may prescribe and with such notice shall pay to the Commission a fee equivalent to one-tenth (1/10) of one percent (1%) of the maximum aggregate price or issued value of the securities."

¹⁶ Paragraph 7.A, SRC Rule 10.1, Amended Implementing Rules and Regulations

Nevertheless, it shall be understood that the foregoing opinion is rendered based solely on the facts and circumstances disclosed and relevant solely to the particular issues raised therein and shall not be used in the nature of a standing rule binding upon the Commission in other cases or upon courts, whether of similar or dissimilar circumstances. If upon investigation, it will be disclosed that the facts relied upon are different, this opinion shall be rendered null and void.

Very truly yours,


CAMILO S. CORREA
General Counsel