Securities and Exchange Commission
PHILIPPINES

BAGONG PILIPINAS

OFFICE OF THE GENERAL COUNSEL

04 June 2024

SEC OGC Opinion No. 24-15

Re: Corporate restructuring of a domestic corporation; Rice and corn industry; and Property swap

DEL ROSARIO AND DEL ROSARIO LAW OFFICES
2515 High Street South Corporate Plaza Tower 2,
26th St. Cor. 11th Ave, Taguig City

Attn: Atty. Saben Loyola
Atty. Rowneylin Sia

Dear Attys. Loyola and Sia:

This refers to your letter dated 22 July 2020, requesting, on behalf of your client, for an opinion on the corporation's proposed conversion to a one hundred percent (100%) foreign-owned company.

In your letter, you disclosed the following:

a) "The corporation is duly organized and existing under Philippine laws primarily engaged in the business of research for breeding and testing of agricultural seeds, distribution and selling on a wholesale basis of seeds and planting materials for local and overseas markets";
b) "It owns parcels of land used for its business";
c) "Currently, it is 60% Filipino-owned and 40% Chinese-owned with an Authorized Capital Stock ("ACS") of PhP500,000.00 divided into 500,000 shares with a par value of PhP1.00 per share";
d) "The corporation's primary purpose is:

> To conduct agricultural research for breeding and testing of new rice varieties and other agricultural crops such as, but not limited to, vegetables, corn, fruit trees, and the like; to engage in the distribution and selling, on wholesale basis, of seeds, seedlings, and planting materials in the local and overseas markets; and to do and perform such other acts necessary or incidental to the accomplishment of the foregoing corporate business insofar as may be allowed by applicable laws and regulations;

e) "The corporation intends to restructure its capital and, in view thereof, desires to know if its intended plan of action outlined below is legally feasible:
   - It will issue new shares or convert outstanding shares to be divided into Class B Common Shares and Class A Preferred Shares the features of which are as follows:

Features	*Class B Common Shares*	*Class A Preferred Shares*
Ownership	May be issued to foreign or Filipino shareholders	Issued to Filipino shareholders only
# of Shares	40%	60%
Par Value	PhP1.67 per share	PhP0.55 per share
Voting rights	With voting rights	With voting rights
Dividend	All of excess in proportion to shareholdings. However, if the	Preferred to received (sic) dividends with a limit of 10% of

	dividends declared for the year is less than 10% of the total par value of Class A shares, then Class B shares will not get any dividends.	total par value, non-guaranteed, non-cumulative, non-participating

- Other intended features of the Class A Preferred Shares are as follows:
  - The dividends are not guaranteed and will be given only if the corporation has unrestricted retained earnings;
  - Each will be of equal rank, preference and priority and identical in all respects, regardless of its issuance;
  - Each shall have the same voting rights as common shares;
  - The preferred shares shall be entitled to a dividend of up to a maximum of 10% of total par value, preferred but non -guaranteed, noncumulative, non-participating. (sic)
  - The preferred shares shall not be convertible into common shares;
  - The preferred shares may be redeemable upon approval of the Board of Directors and at the redemption price equal to the issue price plus any accrued and undistributed dividends. Shareholders' vote shall not be required for redemption. However, the preferred shares shall be redeemable only if the redeemed shares are replaced with at least an equivalent amount of newly issued/paid-in shares so as to maintain the corporation's total paid-in equity and Filipino ownership at the same level immediately prior to redemption. To be able to do this, there will always be unissued shares in the corporation. (sic)
  - Redeemed shares shall be retired and no longer issuable."; and

f) "In addition to the above corporate restructuring, the corporation may transfer via sale its parcels of land to a holding company ("HoldCo"). The corporation is also studying the possibility of investing in HoldCo via property swap. Should the corporation choose to invest in HoldCo, the corporation will purchase up to 60% of HoldCo and it will use its lands as the consideration for the shares it subscribed in HoldCo pursuant to Section 61(b) of our Revised Corporation Code."

You are now asking for an opinion on the following matters:

a) "May the corporation convert into a 100% foreign owned (sic) entity considering the SEC's previous opinion in SEC [OGC Opinion] No. 09-15?";

b) "If 100% foreign ownership is not feasible, whether the (a) intended corporate restructuring of the corporation to be done through the issuance of new shares divided into (or conversion of existing shares to) (sic) common and preferred shares explained in detail in pages 2-4 above is legally feasible; and (b) whether the corporation will maintain its standing as a 60% Filipino-owned company after restructuring;" and

c) "Whether the corporation can use its lands to invest in and acquire 60% of the shares of HoldCo."

Definition of Rice and Corn Industry

As to your first query, the broad definition of the rice and corn industry as defined under Republic Act (R.A.) 3018 and Presidential Decree (P.D.) No. 194, is instructive.

Section 2, P.D. No. 194[1] defines the activities included in "rice and corn industry" as follows:

> As used in this Decree, the term "rice and/or corn industry" shall include the following activities:
>
> a. Acquiring by barter, purchase or otherwise, rice and corn and/or the by-products thereof, to the extent of their raw material requirements when these are used as raw materials in the manufacture or processing of their finished products.
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> b. Engaging in the ***culture, production, milling, processing and trading, except retailing,*** of rice and corn; Provided, That the designation of the area in the

[1] Section 2, Presidential Decree (P.D.) No. 194, *Authorizing Aliens to Engage in the Rice and Corn Industry*, 17 May 1973, as cited in SEC-OGC Opinion No. 09-15.

> culture and production, as well as the trading of the produce in the domestic or foreign markets, shall be under the direction and control of the National Grains Authority.

SEC-OGC Opinion No. 09-15[2] applied the definition of "rice and corn industry," citing Section 1, R.A. No. 3018, *viz.*:

> A definition of "rice and corn industry" is instructive. Under [R.A.] No. 3018, it means "the culture, milling, warehousing, transporting, exportation, importation, handling the distribution, either in wholesale or retail, the provisions of [R.A. No. 1180] to contrary notwithstanding, or the acquisition for the purpose of trade of rice (husked or unhusked) or corn and the by-products thereof.

In addition, Item No. 9, List B of the 12th Foreign Investment Negative List (FINL) provides that only forty percent (40%) foreign equity is allowed for "[c]ulture, production, milling, processing, trading except retailing, of rice and corn and acquiring, by barter, purchase or otherwise, rice and corn and the by-products thereof (Section 5 of P.D. No. 194), subject to period of divestment ([National Food Authority (NFA)] Council Resolution No. 193, [Series of] 1998)."[3]

The corporation's primary purposes as disclosed in your letter are as follows:

a) "to conduct agricultural research for ***breeding and testing*** of new rice varieties and other agricultural crops such as, but not limited to, vegetables, corn, fruit trees, and the like;
b) "to engage in the ***distribution and selling, on wholesale basis***, of seeds, seedlings, and planting materials in the local and overseas markets"; and
c) "to do and perform such other acts necessary of incidental to the accomplishment of the foregoing corporate business insofar as may be allowed by applicable laws and regulations."

"Breeding and testing" of rice and corn may include or connote culture, production, and/or processing of the same which puts the activities within the ambit of the rice and corn industry, so is the wholesale distribution and sale of seeds and seedlings thereof. Thus, the corporation falls within the rice and corn industry, hence, only 40% foreign equity is allowed.

Please note, however, that it might be prudent to consult the National Food Authority (NFA), as the main agency dealing with the rice and corn industry.

Corporate restructuring through issuance of new shares or stock conversion

As to the first part of your second query, ***SEC-OGC Opinion No. 22-17***[4] is instructive as to conversion of existing shares, to wit:

> The power to classify shares is provided under Section 6 of Republic Act (R.A.) No. 11232 or the Revised Corporation Code of the Philippines (RCCP), which states that stock corporations are authorized to divide shares into classes or series of shares, or both, any of which classes or series of shares may have such rights, privileges, or restrictions as may be stated in the AOI. The classes and number of shares which a corporation shall issue are first determined by the incorporators as stated in the AOI filed with the Commission. ***After the corporation comes into existence, they may be altered by the board of directors and the stockholders by amending the AOI.***
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> The conversion of shares can only be effected if the shares have a convertibility feature expressly provided for in the corporation's AOI. For instance, in the absence of an express provision in the AOI as to their convertibility feature, preferred shares cannot be converted into common shares.[5] Further, although the shares may have a convertible feature in the AOI, their conversion is not automatic. ***An amendment of the AOI is required to formalize the conversion which must not result in the watering of stock or issuance of stock in excess of the authorized capital stock of the corporation.***
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> xxxxx
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> Moreover, and among other requirements, in the event that the conversion or reclassification of shares has the effect of changing or restricting the rights of any stockholder or class of shares, or of authorizing preferences in any respect superior to those of outstanding shares of any class, any stockholder of a corporation shall have the right to dissent and demand payment for the fair value of the shares.
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> ***Finally, please note that the reclassification of shares and the amendment of the AOI must be approved by the Commission's Company Registration and Monitoring Department (CRMD), upon showing***

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[2] Section 1, Republic Act (R.A.) No. 3018, Rice and Corn Industry Act, 02 August 1960 as cited in SEC-OGC Opinion No. 09-15 addressed to Sycip Salazar Hernandez & Gatmaitan dated 17 June 2009.
[3] Item No. 20, List B, *Twelfth Foreign Investment Negative List (FINL)*, Executive Order (E.O.) No. 175, Series of 2022, 27 June 2022.
[4] SEC-OGC Opinion No. 22-17 addressed to Padernal and Paras Law Offices dated 23 November 2022.
[5] SEC Opinion addressed to Mr. Leoncio Palanca dated 19 May 1992.

> ***compliance with the above, among other requirements. Thus, we defer to the evaluation by the CRMD as regards the application for amendment to reclassify that will be filed by PMHI.***
>
> To sum up, a corporation may reclassify its shares through an amendment of the AOI, provided that the shares have a convertibility feature expressly provided in the AOI, and subject to approval by the Commission, through CRMD. This authority of a corporation to reclassify its shares includes the creation of redeemable shares subject to compliance with the requirements under the RCCP and the 1982 SEC Rules Governing Redeemable and Treasury Shares. (Citations omitted, emphasis supplied)

As to the issuance of new shares, every corporation has the power and capacity to issue or sell stocks to subscribers and to sell treasury stocks in accordance with the provisions of Republic Act (R.A.) No. 11232 or the Revised Corporation Code of the Philippines (RCCP).[6] Please take note, however, of the pre-emptive rights of the stockholders.

SEC-OGC Opinion No. 23-11[7] provides the following discussion:

> Section 38 of the RCCP provides that "[a]ll stockholders of a stock corporation shall enjoy pre-emptive right to subscribe to all issues or disposition of shares of any class, in proportion to their respective shareholdings, unless such right is denied by the articles of incorporation or an amendment thereto." Since Section 38 of the [RCCP] uses the phrase "all issues or disposition of shares of any class," pre-emptive right extends not only to issuance of new shares resulting from an increase in capital stock, but also to issuance of previously unsubscribed shares which form part of the existing authorized capital stock, as well as to disposition of treasury shares. *Ubi lex non-distinguish nee nos distinguere debemos.* Where the law does not distinguish, courts should not distinguish. (Citations omitted)

Thus, we confirm that a corporate restructuring can be effected through the conversion of existing stocks or the issuance of new stocks ***subject to the evaluation and the requirements to be imposed by the Company Registration and Monitoring Department (CRMD).***

Effect of corporate restructuring

As to the second part of your second query, the same deals with the effect of the capital restructuring which would necessitate the ***determination of factual issues*** such as the amount of outstanding capital stock, the presence or absence of corporate stockholders or corporate layering, and compliance with requirements imposed by the CRMD, among others. As such, we cannot categorically render an opinion on the same.[8]

However, ***for purposes of information only***, we impart the following:

SEC-OGC Opinion No. 19-24[9] discussed the determination of nationality of a corporation, to wit:

> In the case of *Gamboa vs. Teves*, the Supreme Court ruled that the "term 'capital' in Section 11, Article XII of the 1987 Constitution refers only to shares of stock entitled to vote in the election of directors, and thus in the present case only to common shares, and not to the total outstanding capital stock (common and non-voting preferred shares).
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> Pursuant to this, the Commission issued SEC Memorandum Circular No. 8, Series of 2013 (SEC MC No. 8) which was upheld by the Supreme Court in *Roy vs. Herbosa.* SEC MC No. 8 uses the two-tiered test in determining compliance with the required percentage of Filipino ownership. Under the two-tiered test, the 60% required Filipino ownership shall be applied to BOTH: (a) the total number of outstanding shares of stock entitled to vote in the election of directors; AND (b) the total number of outstanding shares of stock, whether or not entitled to vote in the election of directors. (Citations omitted)

In case there is corporate layering, the ***Narra Nickel Mining and Development Corporation*** case[10] provides that either the Control Test or the Grandfather Rule may be used as may be warranted under the prevailing facts.

Property swap for stocks in a holding company

As to your third query, we confirm that lands owned by a corporation can be swapped for stocks in another corporation.

Section 61(b) of the RCCP provides that stocks shall not be issued for a consideration less than the par or issued price thereof. Consideration for the issuance of stock may be property, tangible or intangible, provided that the following requisites occur:

a) The property is ***actually received*** by the corporation;
b) It is ***actually necessary or convenient*** for its use and lawful purposes;

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[6] Section 35, R.A. No. 11232, Revised Corporation Code of the Philippines (RCCP), 23 February 2019.
[7] SEC-OGC Opinion No. 23-11 addressed Tomas Claudio Colleges Inc. dated 19 May 2023.
[8] Section 5.8, SEC Memorandum Circular (MC) No. 15, Series of 2003, 16 December 2003.
[9] SEC-OGC Opinion No. 19-24 addressed to Atty. Dennis Quiokeles dated 24 June 2019.
[10] G.R. No. 195580, 21 April 2014. [Per J. Velasco Jr., Third Division]

c) It must be subject to a ***fair valuation*** equal to the par or issued value of the stocks issued;
d) The valuation shall be ***initially determined by the stockholders or board of directors***; and
e) The valuation is subject to the ***approval*** of the Commission.[11]

Whenever a property or an interest therein is used as consideration for the issuance of shares of stock, the said property or interest should be free from any right of redemption or pre-emption of the other co-owners considering that ***the transfer to the corporation must be in such a manner that the property or an interest therein is capable of being applied to the payment of the corporation's debts or can be subject to levy and sale on execution for the satisfaction of any judgment or decree against the corporation***.[12]

It shall be understood that the foregoing opinion is rendered solely on the basis of the facts, circumstances and documents disclosed/submitted, and should be considered relevant solely to the particular issue raised therein. It shall not be used in the nature of a standing rule binding upon the Commission in other cases or upon the courts whether of similar or dissimilar circumstances.[13] If upon investigation, it will be disclosed that the facts relied upon are different, this opinion shall be rendered null and void.

Please be guided accordingly.

Very truly yours,

for:

ROMUALD C. PADILLA
General Counsel

[11] Section 61(b), RCCP, *supra* Note 6.
[12] SEC-OGC Opinion No. 10-21 addressed to Kapunan Lotilla Garcia & Castillo Law Offices dated 26 May 2010.
[13] Section 7, SEC MC No. 15, Series of 2003, *supra* Note 8.