Securities and Exchange Commission
PHILIPPINES

OFFICE OF THE GENERAL COUNSEL

SEC OGC Opinion No. 22-17
Re: Conversion of Common/Preferred Shares into Redeemable Shares

23 **November 2022**

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Attention: Atty. Edgar Dennis A. Padernal

Dear Sir:

This refers to your letter dated 05 September 2022 requesting for an opinion on behalf of your client, Prime Media Holdings, Inc. (PMHI), pertaining to the proposed conversion of common or preferred shares into redeemable shares to eliminate foreign equity holdings.

In your letter, you disclosed the following matters:

a) PMHI is a publicly-listed holding company duly registered and existing under Philippine laws;
b) During the annual stockholders' meeting on 13 October 2021, the stockholders owning and/or representing five hundred seventy million one hundred fifty-three thousand eight hundred eighty-seven (570,153,887) shares or at least eighty-one point forty-two percent (81.42%) of the outstanding capital stock of PMHI voted in favor of the amendment of the Articles of Incorporation (AOI) of PMHI to include a provision prohibiting foreign ownership of shares, to wit:

> Ownership of the Corporation's shares shall be limited to Philippine citizens, or to corporations, cooperatives, or associations wholly-owned and managed by such citizens, in order to enable the Corporation to invest in shares of stock of corporations, or entities which are required to be wholly owned by Philippine citizens or corporations, cooperatives, or associations wholly-owned and managed by such citizens as provided in Section 11, Article XVI of the Philippine Constitution.

c) The amendment was unanimously approved by the members of the board of directors of PHMI and by the Commission;
d) At present, the authorized capital stock of PMHI is five billion pesos (Php 5,000,000,000.00), divided into the following:
   - Three billion (Php 3,000,000,000.00) common shares with par value of one peso (Php 1.00) per share;
   - One billion (Php 1,000,000,000.00) Series "A" preferred shares with par value of one peso (Php 1.00) per share; and
   - One billion (Php 1,000,000,000.00) Series "B" preferred shares with par value of one peso (Php 1.00) per share;
e) PMHI sent out letters to foreign shareholders through their brokerage companies requesting to transfer or sell their shares to qualified persons, i.e. Filipino citizens;
f) At present, PMHI still has zero point zero six percent (0.06%) of foreign equity remaining because some foreign shareholders cannot be located;

g) To fully eliminate the remaining foreign equity, PMHI intends to redeem all foreign-owned shares by creating Series "C" redeemable shares with a par value of one peso (Php 1.00) which may be redeemed in cash;
h) At present, the foreign shareholders own the following:
   - three hundred thousand thirty-six thousand and two hundred seventy-eight common shares (336,278) Common shares; and
   - one hundred nine thousand six hundred and fifty (109,650) Series "A" preferred shares;
i) All Series "A" preferred shares amounting to 109,650 shall be converted into common shares at a conversion rate of twenty-five (25) preferred shares to 1 common share after implementation of a par down from one peso (Php 1.00) to four centavos (Php 0.04);
j) The conversion, its rate, and the par-down were approved by the board and subject to shareholders' approval on 23 September 2022;
k) The proposed conversion of Series "A" preferred shares to common shares will result to the issuance of four thousand three hundred eighty-six (4,386) common shares;
l) Thereafter, all foreign owned shares totaling three hundred forty thousand six hundred sixty-four (340,664) common shares shall be converted into Series 'C" redeemable shares with a par value of one peso (Php 1.00) per share;
m) PMHI intends to redeem all Series "C" shares in cash and later reclassify Series "C" into common shares; and
n) At present, PMHI has no unrestricted retained earnings but "PMHI has sufficient cash on hand to cover said redemption amount and will not cause insolvency or the inability of PMHI to meet debts when due."

You are now requesting for an opinion on the following:

a) "In compliance with the duly-approved amended AOI that requires 100% Filipino shareholders, may PMHI create Series "C" redeemable shares to reclassify all foreign-held common shares into redeemable shares by amendment of the AOI that will be approved by the Board of Directors and its stockholders?";
b) "May PHMI redeem the Series "C" shares owned by foreign shareholders in cash regardless of the existence of unrestricted retained earnings?"; and
c) "After the redemption, may PMHI reclassify all Series "C" shares into common shares by amendment of its AOI with the approval of the Board and its shareholders?"

<u>Discussion on the first query</u>

Power to classify and reclassify shares

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),[1] 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.[2]

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.[3] 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.***[4]

In your letter, there are two (2) conversions, namely: (1) Series "A" preferred shares to common shares (First Conversion); and (2) Common shares to Series "C" redeemable shares (Second Conversion).

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[1] Republic Act (R.A.) No. 11232, *Revised Corporation Code of the Philippines (RCCP)*, 23 February 2019.
[2] SEC-OGC Opinion No. 10-18, addressed to Nolledo Hermosura & Uriarte-Tan dated 12 April 2010
[3] SEC Opinion addressed to Mr. Leoncio Palanca dated 19 May 1992.
[4] SEC-OGC Opinion No. 10-18, *supra.*

As to the First Conversion, a convertibility feature must be specifically indicated in the AOI in order to effect the same. Notably, PMHI's AOI[5] ***does not expressly provide for a convertibility feature***. It only contains an authority to the board of directors to adopt resolutions regarding convertibility, among others.[6] As such, PMHI's AOI needs to be amended to add a convertibility feature and to formalize the conversion subject to the foregoing rules.

As to the Second Conversion, we note that you did not indicate whether Series "C" redeemable shares are preferred or common shares. We note, however, that redeemable shares are usually preferred shares.[7] As such, a convertibility feature should also be indicated in the AOI.

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.[8]

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 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.

Discussion on the second query

Nature of redeemable shares

Redeemable shares may be issued by the corporation ***when expressly provided in the articles of incorporation***. They are shares which may be purchased by the corporation from the holders of such shares upon the expiration of a fixed period, regardless of the existence of unrestricted retained earnings in the books of the corporation, and ***upon such other terms and conditions stated in the articles of incorporation and the certificate of stock representing the shares, subject to rules and regulations issued by the Commission.***[9] As such, the redeemable characteristic of the shares must be specifically stated in the AOI.

In ***Republic Planters Bank, Inc. vs. Hon. Enrique Agana Sr.***, the Court discussed the nature of redeemable shares, to wit:

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[5] Attached to your letter as Annex "A"

[6] SEVENTH:

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> The Board of Directors is hereby expressly granted and authorized to adopt resolutions authorizing the establishment, designation and issuance of one or more series for such number of shares and relative rights and preferences as it may deem beneficial to the Corporation. The resolution thus adopted shall be recorded with the Securities and Exchange Commission and the Philippine Stock Exchange, if required, and thereupon deemed and amendment and part of this Articles of Incorporation. The resolution(s) herein authorized to be adopted by the Board of Directors shall specify with respect to a given series, the following:
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> xxxx
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> (g) the terms and conditions, if any, on which shares of such. series shall be convertible into, or exchangeable for, shares of stock of any other class or classes, or other series of the same class of the Corporation;
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> xxxx

[7] *Republic Planters Bank, Inc. vs. Hon. Enrique Agana Sr.*, G.R. No. 51765, 03 March 1997.

[8] Section 80, RCCP.

[9] Section 8, RCCP.

> Redeemable shares, on the other hand, are shares usually preferred, which by their terms are ***redeemable at a fixed date***, or ***at the option of either issuing corporation, or the stockholder, or both*** at a certain redemption price. A redemption by the corporation of its stock is, in a sense, a ***repurchase of it for cancellation***.[10]

The issuance of redeemable shares may be likened to ***temporary borrowings which enables a corporation to adjust its capital structure to meet its varying conditions.*** [11] This redemption feature is envisaged to effectively eliminate the market volatility risks on the side of the share owners. Undoubtedly, these are clear advantages and benefits that inure to the share owners who, on one hand, prefer a stable dividend yield on their investments and, on the other hand, want security from the uncertainty of market forces over which they do not have control.[12]

Power to acquire its own shares

For a corporation to be able to acquire its own shares, the following conditions must be present:

(1) it is for a legitimate and proper corporate purpose;
(2) there shall be unrestricted retained earnings to purchase the same and its capital is not thereby impaired;
(3) the corporation acts in good faith and without prejudice to the rights of creditors and stockholders; and
(4) the conditions of corporate affairs warrant it. If the aforementioned conditions are present, a corporation may acquire the shares of its alien stockholders to comply with the constitutional requirements prescribing the minimum capital stock ownership of Filipino citizens in educational institutions. [13]

This general rule is provided under Section 40 of the RCCP, to wit:

> Provided that the corporation has unrestricted retained earnings in its books to cover the shares to be purchased or acquired, a stock corporation shall have the power to purchase or acquire its own shares for a legitimate corporate purpose or purposes, including the following cases:
> (a) To eliminate fractional shares arising out of stock dividends;
> (b) To collect or compromise an indebtedness to the corporation, arising out of unpaid subscription, in a delinquency sale, and to purchase delinquent shares sold during said sale; and
> (c) To pay dissenting or withdrawing stockholders entitled to payment for their shares under the provisions of this Code. [14]

The exception to the foregoing rules pertains to redeemable shares. Jurisprudence provides that the present Code allows redemption of shares even if there are no unrestricted retained earnings on the books of the corporation. This, in effect, qualifies the general rule that the corporation cannot purchase its own shares except out of current retained earnings. However, while redeemable shares may be redeemed regardless of the existence of unrestricted retained earnings, this is subject to the condition that the corporation has, after such redemption, assets in its books to cover debts and liabilities inclusive of capital stock. Redemption, therefore, may not be made where the corporation is insolvent or if such redemption will cause insolvency or inability of the corporation to meet its debts as they mature.[15]

For the protection of the stockholders, a corporation that has issued redeemable shares shall set up and maintain a sinking fund to be deposited with a trustee bank which shall not be invested in risky and speculative ventures. A sinking fund refers to a fund set up by a corporation where cash is gradually set aside in order to accumulate the amount necessary to meet the redemption price of redeemable shares at specified dates in the future.[16]

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[10] *Republic Planters vs. Agana, supra.*
[11] SEC-OGC Opinion No. 07-03 addressed to Ms. Teodora San Pedro dated 07 March 2007.
[12] *Philippine Coconut Producers Federation Inc. (COCOFED), et. al. vs. Republic of the Philippines,* G.R. No. 177857-58, 17 September 2009.
[13] SEC-OGC Opinion No. 14-33 addressed to Tiongco Siao and Abello dated 18 November 2014.
[14] Section 2(c), *The 1982 SEC Rules Governing Redeemable and Treasury Shares* (The 1982 SEC Rules), 26 April 1982.
Unrestricted Retained Earnings refer to the undistributed earnings of the corporation which have not been allocated for any managerial, contractual, or legal purposes and which are free for distribution to the stockholders as dividends.
[15] *Republic Planters vs. Agana, supra.*
[16] SEC-OGC Opinion No. 09-21 addressed to KEPCO Philippines Corporation dated 13 August 2009.

Thus, redeemable shares may be redeemed even if there are no unrestricted retained earnings on the books of the corporation. This is subject to the condition that the corporation has, after such redemption, assets in its books to cover debts and liabilities inclusive of capital stock.[17]

Based on the foregoing, we confirm that PMHI may redeem its redeemable shares, ***regardless of the existence of unrestricted retained earnings, provided that it has, after such redemption, sufficient assets in its books to cover debts and liabilities inclusive of capital stock.***[18]

<u>Discussion on the third query</u>

Effect of redemption

Redemption is a repurchase or a reacquisition of stock by a corporation which issued the stock in exchange for property, whether or not the acquired stock is *cancelled*, *retired* or *held in the treasury*. Essentially, the corporation gets back some of its stock, distributes cash or property to the shareholder in payment for the stock, and continues in business as before.[19]

The redeemable shares, once redeemed, becomes part of the treasury shares of the corporation. Treasury shares do not revert to the unissued shares of the corporation but are regarded as property acquired by the corporation which may be ***reissued*** or sold by the corporation at a price to be fixed by the Board of Directors; provided, however, **that in the case of redeemable shares reacquired, the same shall be considered retired and no longer issuable, *<u>unless otherwise provided in the AOI</u>*.**[20] Conversely, where the AOI is silent on the reissuable nature of the redeemed shares, the same shall be considered retired.[21] Once retired, the authorized capital stock of the corporation will be reduced by the corresponding number of shares since the shares can no longer be reissued. This deduction should be reflected in the AOI through an amendment. In this case, the repurchase was effected for cancellation.[22]

Based on the foregoing, there are two types of treasury shares out of the redemption of shares. First is ***non-reissuable,*** as when the AOI is silent on the reissuable nature of the redeemable shares. The same will be considered retired and can no longer be reissued. Second is ***reissuable,*** when the AOI itself specifically provides for such effect of redemption.[23]

As to your third query, we note that PMHI's AOI is ***silent*** as to the effect of redemption. As it stands, a redemption, if effected, would entail retirement of the shares. In order to enable PMHI to reissue the same, an amendment to the AOI must be made to specifically provide that after redemption, the redeemed shares shall be reissued as common shares, ***subject to other requirements to be imposed by the CRMD***.

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. If upon investigation, it will be disclosed that the facts relied upon are different, this opinion shall be rendered null and void.[24]

Please be guided accordingly.

Very truly yours,

ROMUALD C. PADILLA
General Counsel

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[17] *Republic Planters vs. Agana, supra.*
[18] Section 5(5), *The 1982 SEC Rules, supra.*
[19] *Commissioner of Internal Revenue vs. Court of Appeals, et. al.,* G.R. No. 108576, 20 January 1999.
[20] Section 3(2), *The 1982 SEC Rules, supra.*
[21] SEC-OGC Opinion No. 19-20 addressed to Quadriver Energy Corporation dated 27 May 2019.
[22] SEC-OGC Opinion No. 06-35 addressed to Ms. Danielle Maria L. Sales-Tort dated 07 September 2006.
[23] SEC-OGC Opinion No. 19-20, *supra.*
[24] Section 7, SEC Memorandum Circular (MC) No. 15-03, Series of 2003 dated 16 December 2003.