



Republic of the Philippines
Department of Finance
Securities and Exchange Commission

OFFICE OF THE GENERAL COUNSEL

20 December 2019

SEC-OGC Opinion No. 19-60

RE: Shares Previously under Escrow, Liquidation;
Condonation of Corporate Rights

ATTY. FRANCES CM AGUINDADAO-ARABE

Corporate Secretary
Universal Leisure Club, Inc.
Unit 703 Globe Telecom Plaza II,
Cor. Madison and Pioneer Sts.,
Mandaluyong City

Dear Ms. Aguindadao-Arabe:

We write in response to your letter dated 14 September 2014 requesting for an opinion regarding the (1) validity and inclusion of the shares of stock acquired through a Development Agreement which were previously under an Escrow Agreement, for purpose of determining quorum, (2) stockholder's waiver of participation in the distribution of assets of a corporation undergoing liquidation, and (3) stockholder's entitlement to properties after liquidation vis-à-vis existing claimants who gained favorable decisions from regular courts.

You averred that Universal Leisure Club, Inc. ("Club"), a non-profit domestic corporation whose Registration of Securities and Permit to Sell Securities to the Public was revoked on 28 June 2004, was organized primarily to promote social, recreational and athletic activities among its members by constructing, developing, and maintaining, initially, at least five (5) component clubs consisting of a mountain golf and nature resort, a city sports club, a city business club, etc. ("Project"). To carry out the Club's purpose, it entered into a Development Agreement ("Agreement") with Universal Leisure Corporation ("Developer"). A perusal of the Agreement dated 15 November 1996 attached to your letter disclosed that among its salient features are as follows:

Xxx"

"E. DEVELOPER has agreed to assign its rights to purchase the Additional Property which UNIVERSAL CLUB needs to achieve its primary purpose, and to pay, by way of equity participation in UNIVERSAL CLUB, the minimum amount of P2.66 BILLION (the "Acquisition Cost") xxx. (emphasis supplied)

"F. DEVELOPER has likewise undertaken to pay, also by way of equity participation in UNIVERSAL CLUB, the minimum amount of P2.54 BILLION (the "Development Cost") for the construction and development of the Project. (emphasis supplied)

xxx"

"3. DEVELOPER shall xxx on behalf of UNIVERSAL CLUB, complete the construction and development of the Project xxx.

"6. In consideration of DEVELOPER's capital contribution equivalent to the Acquisition Cost and the Development Cost, UNIVERSAL CLUB has agreed to issue to DEVELOPER a total of 11,250 shares representing the remaining unissued shares out of its authorized capital stock. These shares shall be issued on a quarterly basis to DEVELOPER as the development of the project progresses at the ratio of 1 share for at least P500, 000.00 worth of Acquisition Cost and Development Cost actually contributed for the Project by the DEVELOPER. Provided, however, that the last 5,000 shares of the remaining 11,250 shares shall issue only to the DEVELOPER upon completion and full turn-over of the five (5) components of the Project. (emphasis supplied)

Xxx"

You likewise declared that only 2 out of the 5 destinations were completed in 2003. Since the completion of the entire project is no longer feasible, the dissolution of the Club is being considered. However, in a special shareholders' meeting held on 22 April 2014 for the dissolution of the Club, the existence of quorum was questioned by the members present, specifically, the Developer's use of 3,615 shares (including the 2,104 shares previously in escrow) to constitute a quorum and allow the Developer to vote on the issue of the Club's dissolution.

In view of the foregoing, you seek clarification on the following:

1. Whether the shares of the Developer, acquired pursuant to the Development Agreement and which were previously under Escrow Agreement, can be recognized during the shareholders' meeting as valid shares for purpose of determining quorum and voting for dissolution?
2. Should the answer in question No. 1 be in the affirmative, whether or not the Developer can waive its right to participate in the distribution of assets despite its participation in the quorum and voting?
3. Who among the shareholders are entitled to equal share from the liquidation of properties and how will existing claimants who have gained favorable decisions (final) from the regular courts over their claims for refund and currently seeking the implementation thereof, be treated in the process of liquidation.¹

At the outset, it bears stressing that the Commission, as a matter of policy, refrains from rendering categorical opinions on issues which may potentially be litigated in the future in

¹ Additional questions pursuant to Atty. Aguindadao-Arabe's Letter dated 10 October 2014.

an intra-corporate and/or civil case such as matters involving the substantive and contractual rights of private parties who would, in all probability, contest the same in court if the opinion turns out to be adverse to their interest,² and on matters which necessarily require a review and interpretation of contracts or on their validity since interpretation of contract is justiciable in nature and contract review calls for legal examination of contract on a general basis and not on specific legal issues.³

Considering that the issues you presented fall within the ambit of the afore-said policy consideration, we refrain from rendering categorical opinions on the same. However, for information purposes only, the following may be instructive.

Relative to the first issue, the nature of Development Agreement and the rights of holders of shares in escrow must necessarily be determined. In previous opinions,⁴ the Commission held that holders of escrow shares are not entitled to the rights pertaining to a stockholder until the conditions set forth for the release of such shares are fully met. The reason lies on the fact that the shares he is supposed to be entitled to are not yet actually issued to him, thus he is not yet the owner of said shares and consequently, he cannot be accorded the rights belonging to a regular stockholder.⁵ Consequently, the Developer's use of the subject shares and its validity for the purpose of determining quorum depends on whether the conditions for release of the said shares were met, in accordance with the Escrow Agreement vis-à-vis the Development Agreement.

In addition, while the Agreement provides that the shares were issued "***in consideration of DEVELOPER's capital contribution equivalent to the Acquisition Cost and the Development Cost***", the same must be clearly analyzed to determine whether such provision can be considered as a subscription contract and whether there was a valid consideration for the shares.

It cannot be gainsaid that stock corporations have the express and inherent power to issue or sell stocks,⁶ which is ordinarily carried out through a subscription contract.⁷ The power to issue shares of stock in a corporation is lodged in the board of directors and stockholders' meeting is not required considering that additional issuances of shares of stocks from the approved authorized capital stock do not need approval from the stockholders.⁸ Since the power to approve the opening for subscription and issuance of shares from the unissued authorized capital stock is not expressly granted to the

² SEC Memorandum No. 15 Series of 2003 as cited in SEC-OGC Opinion 15-09 dated 27 August 2015.

³ *Id.*

⁴ Mr. Delfin L. Gonzales, 19 May 1989, SQB June 1989 p. 34 and Atty. Enriwue M. Bello, 20 Nov. 1989; SQB March 1990 p. 66.

⁵ Mr. Delfin L. Gonzales, 19 May 1989, SQB June 1989 p. 34 citing (Blythe vs Doherty 73 F (2d 779, 803, C.C.A).

⁶ Section 36(6), Corporation Code now Section 35 (f) of the RCC)

⁷ Section 59. Subscription contract. – Any Contract for the acquisition of unissued stock in an existing corporation or a corporation still to be formed shall be deemed a subscription within the meaning of this Title, notwithstanding the fact that the parties refer to it as a purchase or some other contract.

⁸ Majority Stockholders of Ruby International Corporation vs Miguel Lim, GR 165887, 6 June 2011 citing (Dee v SEC, 199 SCRA 238 (1999)).

stockholders by any provision of the Revised Corporation Code (RCC), the same, as a general rule, is subject to the pre-emptive rights under Section 38⁹ of the RCC.

Further, Section 61 of the RCC sets forth the valid considerations for issuance of shares, to wit:

SEC. 61. Consideration for Stocks. – Stocks shall not be issued for a consideration less than the par or issued price thereof. Consideration for the issuance of stock may be:

- (a) Actual cash paid to the corporation;
- (b) Property, tangible or intangible, actually received by the corporation and necessary or convenient for its use and lawful purposes at a fair valuation equal to the par or issued value of the stock issued;
- (c) Labor performed for or services actually rendered to the corporation;
- (d) Previously incurred indebtedness of the corporation;
- (e) Amounts transferred from unrestricted retained earnings to stated capital;
- (f) Outstanding shares exchanged for stocks in the event of reclassification or conversion;
- (g) Shares of stock in another corporation; and/or
- (h) Other generally accepted form of consideration.

Where the consideration is other than actual cash, or consists of intangible property such as patents or copyrights, the valuation thereof shall initially be determined by the incorporators or the board of directors, subject to approval of the Commission.

Shares of stock shall not be issued in exchange for promissory notes or future service. The same considerations provided for in this section, insofar as they may be applicable, may be used for the issuance of bonds by the corporation.

As to the second issue, apropos is the *Trust Fund Doctrine*, which provides that subscriptions to the capital stock of a corporation constitute a fund to which the creditors have a right to look for the satisfaction of their claims. The assets of a dissolved corporation belong to the stockholders.¹⁰ However, the corporate debts must be paid and its obligations discharged before the proceeds obtained in liquidating the assets may be distributed among the stockholders. That is the underlying principle in the distribution of corporate assets.¹¹

⁹ Section 39 of the Old Corporation Code

¹⁰ A.F. Agbayani. III COMMENTS AND JURISPRUDENCE ON THE COMMERCIAL LAWS OF THE PHILIPPINES 651 (1996)

¹¹ SEC Opinion No. 08-04 dated 04 February 2008 addressed to Sycip Salazar Hernandez & Gatmaitan

Thus, a corporation is not authorized to condone a debt/receivables owing it. Debts due to a corporation constitute a portion of its assets which constitutes a "Trust Fund" for the benefit of the creditors, and which the creditors may claim. Gratuitous abandonment of the payment of the debt if done to the prejudice of creditors and stockholders may constitute an ultra-vires act.¹²

With respect to the third issue, liquidation is a necessary consequence of the dissolution of a corporation. It is the process of settling the affairs of said corporation, which consists of adjusting the debts and claims, that is, of collecting all that is due the corporation, the settlement and adjustment of claims against it and the payment of its just debts.¹³ It is specifically governed by Section 139 of the RCC, which reads:

"SEC. 139. Corporate liquidation. – "xxx...., every corporation whose charter expires by its own limitation or is annulled by forfeiture or otherwise, or whose corporate existence for other purposes is terminated in any other manner, shall nevertheless be continued as a body corporate for three (3) years after the time when it would have been so dissolved, for the purpose of prosecuting and defending suits by or against it and enabling it to settle and close its affairs, to dispose of and convey its property and to distribute its assets, but not for the purpose of continuing the business for which it was established.

At any time during said three (3) years, **the corporation is authorized and empowered to convey all of its property to trustees for the benefit of stockholders, members, creditors, and other persons in interest.** From and after any such conveyance by the corporation of its property in trust for the benefit of its stockholders, members, creditors and others in interest, all interest which the corporation had in the property terminates, the legal interest vests in the trustees, and the beneficial interest in the stockholders, members, creditors or other persons in interest.

Except as otherwise provided for in Sections 93 and 94 of this Code, upon the winding up of corporate affairs, any asset distributable to any creditor or stockholder or member who is unknown or cannot be found shall be escheated in favor of the national government.

Except by decrease of capital stock and as otherwise allowed by this Code, no corporation shall distribute any of its assets or property except upon lawful dissolution and after payment of all its debts and liabilities."

¹² De Casa, p. 130, citing SEC Opinion dated 19 June 1987 addressed to Philippine Contractors Accreditation Board

¹³ Anthony S. Yu v Joseph S. Yukayguan, GR 177549, 18 June 2009 citing (China Banking Corp v M. Michelin & Cie, 58 Phil 261, 266 (1933).

Liquidation entails winding up the affairs of the corporation through the collection of assets, the payment of all its creditors, and the distribution of the remaining assets, if any, among the stockholders thereof in accordance with their contracts, or if there be no special contract, on the basis of their respective interests. The manner of liquidation or winding up may be provided for in the corporate by-laws and this would prevail unless it is inconsistent with law.¹⁴

Thus, in the event of the Club's liquidation, its properties shall be collected and used to pay all its creditors and the remainder of such assets shall be distributed among the stockholders thereof in accordance with their contracts, or on the basis of their respective interests. There can be no distribution of assets among the stockholders without first paying corporate debts. Under the Trust Fund Doctrine, the capital stock, property, and other assets of a corporation are regarded as equity in trust for the payment of corporate creditors, who must first be paid before any corporate assets may be distributed among stockholders.¹⁵ As such, any disposition of corporate funds and assets to the prejudice of creditors is null and void.¹⁶ The stockholders cannot claim for refund, before the actual dissolution of the corporation and the liquidation of its debts and liabilities as it would amount to appropriation by, and the distribution among them, of part of the corporate assets, which Section 139 of the RCC proscribes.

However, when the assets of the corporation are insufficient to pay all the claims, the issue on prioritizing the right of a claimant against the assets of a corporation sought to be dissolved and liquidated in the payment of his claims becomes material. Thus, the following order in the application of assets may be considered:

1. When the corporation is insolvent, the creditors of the corporation are entitled to have all its assets distributed first among them according to their respective rights and priorities.¹⁷
2. Stockholders, members, directors, or officers of the corporation who are also its creditors as a result of a legitimate or proper loan or claim must be paid next to the other creditors of the corporation.¹⁸
3. The remaining assets are then to be distributed among the stockholders or members in proportion to their shareholdings or interest in the absence of any provision to the contrary.¹⁹

¹⁴ Anthony S. Yu v Joseph S. Yukayguan, GR 177549, 18 June 2009 citing (Campos, THE CORPORATION CODE: COMMENTS, NOTES AND SELECTED CASES, Vol. 2, p. 415 (1990)).

¹⁵ Philip Turner and Elnora Turner v Lorenzo Shipping Corp, GR 157479, 24 November 2010 citing (Boman Environment Development Corporation v CA, GR L-77860, 22 November 1988).

¹⁶ *Id.*

¹⁷ Hector S. De Leon and Hector M. De Leon, Jr., THE CORPORATION CODE OF THE PHILIPPINES ANNOTATED 9TH EDITION, p. 750 (2006) citing (18 Am.Jur. 1029-1030).

¹⁸ *Id.*

¹⁹ Hector S. De Leon and Hector M. De Leon, Jr., THE CORPORATION CODE OF THE PHILIPPINES ANNOTATED 9TH EDITION, p. 750 (2006) citing (F. Guanzon & Sons, Inc. v Register of Deeds, 6 SCRA 373).

Considering that the share of stockholders in the remaining assets of the corporation depends on their contracts or their respective interests, i.e. common stock and preferred stock with respect to distribution of assets, said contracts or interests must be carefully reviewed.

We hope the foregoing discussion has provided you sufficient guidance in resolving your concerns.



ROMUALD C. PADILLA
Officer-In-Charge