Republic of the Philippines
Department of Finance
Securities and Exchange Commission
OFFICE OF THE GENERAL COUNSEL

11 October 2019

SEC-OGC Opinion No. 19-50
Re: Condonation of Subscriptions Receivables or Cancellation of Subscriptions

TAN VENTURANZA VALDEZ
2704 East Tower, Philippine Stock Exchange Centre
Exchange Road, Ortigas Center
1605 Pasig City, Metro Manila

Attention: **ATTY. JASON C. NALUPTA**
ATTY. ANN MARGARET K. LORENZO

Attorneys:

This refers to your letter dated 23 June 2016, filed before the Office of the General Counsel, on behalf of your client, Philippine Realty and Holdings Corporation (PRHC), requesting for a legal opinion on whether the corporation has the power under the Corporation Code, or any other law, to condone subscriptions receivables due or to partially cancel the subscriptions of its stockholders.

In said letter, you represented that PRHC is a company whose common shares have been listed with the Philippine Stock Exchange since 1988. On 9 February 2016, this Commission approved PRHC's equity restructuring wherein the par value of the latter's shares were reduced from One Peso (Php 1.00) to Fifty Centavos (Php 0.50) per share, and thereby, resulting in the increase of PRHC's additional paid-in capital (APIC) which was used to eliminate the corporation's deficit.[1] You also stated that a significant number of PRHC's outstanding shares were only partially-paid, and as such, were not immediately tradeable. As such, the PRHC's Board of Directors has been considering available options to help make its listed securities more attractive in the market by ensuring that there are more fully-paid and immediately tradeable shares that could be transacted in the stock exchange. Thus, you raised the following issues:

1. Can PRHC condone subscription receivables due from its shareholders?
2. Can PRHC consider the portion paid by a partially-paid shareholder as full payment for the corresponding number of shares and cancel the subscription as to the rest?
3. If either or both options are legally available to PRHC, what are the requirements for the same?

[1] Certificate of Decrease in Capital Stock of Philippine Realty and Holdings Corporation (PRHC) dated 9 November 2015, as attached in the 23 June 2016 letter-request for opinion of PRHC.

As to your first query, it is relevant to discuss the "Trust Fund Doctrine", which emanates from the last paragraph of Section 139 of the Revised Corporation Code (RCC) (previously Section 122 of the Corporation Code). In the case of ***Philippine Long Distance Telephone Company vs National Telecommunications Commission (G.R. No. 152685, 4 December 2007)***, the Supreme Court discussed the concept of capital and its treatment as a "trust fund" in favor its creditors, to wit:

> "The term "capital" and other terms used to describe the capital structure of a corporation are of universal acceptance and their usages have long been established in jurisprudence. Briefly, capital refers to the value of the property or assets of a corporation. The capital subscribed is the total amount of the capital that persons (subscribers or shareholders) have agreed to take and pay for, which need not necessarily be, and can be more than, the par value of the shares. **In fine, it is the amount that the corporation receives, inclusive of the premiums if any, in consideration of the original issuance of the shares.** In the case of stock dividends, it is the amount that the corporation transfers from its surplus profit account to its capital account. **It is the same amount that can be loosely termed as the "trust fund" of the corporation. The "Trust Fund" doctrine considers this subscribed capital as a trust fund for the payment of the debts of the corporation, to which the creditors may look for satisfaction. Until the liquidation of the corporation, no part of the subscribed capital may be returned or released to the stockholder (except in the redemption of redeemable shares) without violating this principle.** Thus, dividends must never impair the subscribed capital; **subscription commitments cannot be condoned or remitted**; nor can the corporation buy its own shares using the subscribed capital as the considerations therefor." (Emphasis supplied)

In the case of ***Donna C. Halley vs Printwell, Inc. (G.R. No. 157549, 30 May 2011)***, the Supreme Court, citing the American case of *Wood vs Dummer*, declared that "[i]t is established doctrine that subscriptions to the capital of corporation constitute a fund to which creditors have a right to look for satisfaction of their claims and that the assignee in insolvency can maintain an action upon any unpaid stock subscription in order to realize assets for the payment of its debts."

Upon the acceptance of a stock subscription by a corporation, the subscription becomes a binding contract to which the subscriber cannot withdraw.[2] Neither does the corporation have the power to release an original subscriber from its subscription, and as against the creditors, a reduction of the capital stock can only take place in the manner and under the conditions prescribed by law or the charter of the corporation.[3] To do so would be violative of the Trust Fund Doctrine since it does not fall under any of the allowable instances where a corporation may distribute its assets to its creditors and stockholders. As such, subscription contracts cannot be cancelled by the Board of Directors without justifiable cause. This is tantamount to relieving an original

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[2] SEC Opinion dated 27 March 1984 and addressed to Mr. Joseph E. Hayes.
[3] Philippine Trust Company vs Rivera, G.R. No. L-19761, 29 January 1923.

subscriber from the subscription, a contractual obligation, which a corporation has no power to do so.[4]

Further, the Commission previously opined that APIC already forms part of equity emanating from the original subscription agreement. APIC, as a premium, forms part of the capital of the corporation and therefore, falls within the purview of the Trust Fund Doctrine.[5] Thus, APIC is also governed by the doctrines and restrictions enunciated in the above-stated jurisprudence.

Therefore, PRHC may not condone subscription receivables due from shareholders as it violates the Trust Fund Doctrine.

As to your second query, Section 63 of the RCC (previously Section 64 of the Corporation Code), which enunciates the "Doctrine of Indivisibility of Subscription Contracts", provides that "[n]o certificate of stock shall be issued to a subscriber until the full amount of the subscription together with interest and expenses (in case of delinquent shares), if any is due, has been paid."

The Commission has consistently opined that a subscription is one, entire and indivisible whole contract. This indivisibility of subscription is absolute as Section 64 of the Corporation Code (now Section 63 of the RCC) speaks no exception.[6]

"The purpose of the doctrine is to prevent the partial disposition of a subscription, which is not fully paid, because if it is permitted and the stockholder subsequently becomes delinquent in the payment of his subscription, the corporation may not be able to sell the as many of his subscribed shares as would be necessary to cover the total amount from him pursuant to Section 68 of the Corporation Code (now Section 67 of the RCC)." [7]

Applying the aforementioned doctrine, PRHC cannot issue certificates of stock for the portion of the subscription that is paid and cancel the portion which remains unpaid as it violates the doctrine of indivisibility of subscription contracts. In effect, it is also condonation of part of the subscription of a stockholder, which is violative of the Trust Fund Doctrine.

From the foregoing, *your final query* no longer needs to be addressed.

It shall be understood that this opinion is rendered based solely on the facts and circumstances disclosed and 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

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[4] SEC Opinion dated 6 October 1982 addressed to Mr. Alejandro E. Santos, citing Velasco vs Poizat; SEC Opiion dated 21 January 1991 addressed to Lorelei Torralba Gangayco.
[5] SEC Opinion No. 14-13 dated 11 June 2014 and addressed to Isla Lipana & Co.
[6] SEC Opinion No. 06-13 dated 6 March 2006 and addressed to Atty. Roderick R.C. Salazar III.
[7] Hector de Leon, the Corporation Code of the Philippines, Annotated, p. 578 (2010).

cases or upon the courts whether of similar or dissimilar circumstances.[8] If, upon further inquiry or investigation, it will be disclosed that the facts relied upon are different, this opinion shall be rendered void.

Please be guided accordingly.

ROMUALD C. PADILLA
Officer-in-Charge

[8] SEC Memorandum Circular 2003-15, No.7