



Republic of the Philippines
Department of Finance
Securities and Exchange Commission

OFFICE OF THE GENERAL COUNSEL

27 May 2019

SEC-OGC Opinion No. 19-20

Re: Redemption of Preferred
Shares; Subscribed Capital Stock

QUADRIVER ENERGY CORPORATION

2/F, Highway 54 Plaza
986 Stanford St., EDSA
Wack-Wack, Mandaluyong City

Attention: Atty. Roland G. Rosales

Dear Atty. Rosales:

This refers to your letter dated 27 November 2017, requesting for an opinion on the redemption of preferred shares.

Your letter states that Quadraver Energy Corporation ("Quadraver") is engaged in the business of building, constructing, generating, operating, and maintaining power plants which produce energy derived from coal, fossil, fuel, geothermal, natural gas, biomass, solar, wind, hydroelectric, and other viable sources of power. Quadraver was registered with this Commission in 2011. In 2016, Quadraver decreased its capital stock to one billion twelve million four hundred seventy-six thousand pesos (Php 1,012,476,000.00) and reclassified its shares into common and redeemable preferred shares.

The letter likewise states that Sta. Clara Group, Inc. is currently the sole subscriber to the preferred shares, and that the Company intends to redeem and retire two million three hundred fifty-eight thousand six hundred ninety (2,358,690) preferred shares issued to Sta. Clara Group, Inc.

In connection to this, the issues are:

1. Whether Quadraver can redeem the preferred shares even without retained earnings and without violating existing laws as well as the trust fund doctrine;
2. Whether Quadraver's redemption of the preferred shares will not result to insolvency; and

3. Whether the redemption of the preferred shares will not result to a reduction of the subscribed capital stock of Quadriver.

With regard to the first query, Section 40 of the Revised Corporation Code (Code) provides:

*"Section 40. Power to acquire own shares. -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: xxx"*¹ (Emphasis supplied)

"The requirement of unrestricted retained earnings to cover the shares is based on the trust fund doctrine which means that the capital stock, property and other assets of a corporation are regarded as equity in trust for the payment of corporate creditors."² The rationale is that a corporation's creditors are preferred over the stockholders.³

Moreover, Section 3(1) of the SEC Rules Governing Redeemable and Treasury Shares (the "1982 Rules") states that: *"No corporation shall redeem, repurchase or reacquire its own shares, of whatever class, unless it has an adequate amount of unrestricted retained earnings to support the cost of the said shares xxx"*⁴ Hence, the existence of unrestricted retained earnings is required before a corporation can redeem its shares.

However, an exception to the general rule stated in Section 3(1) of the 1982 Rules is that: *"When the shares are reacquired in the redemption of redeemable shares of the corporation or pursuant to the conversion right of convertible shares of the corporation, in accordance with the provision expressly provided for in its articles of incorporation and certificates of stock representing said shares of the corporation, xxx"*⁵ This is based on Section 8 of the Code which provides:

*"Section 8. 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*

¹ Republic Act No. 11232, An Act Providing for the Revised Corporation Code of the Philippines (exact reproduction of Section 41 of The Corporation Code of the Philippines, Batas Pambansa Blg. 68)

² Boman v. C.A., 249 Phil. 495-505 (1988).

³ *Id.*

⁴ SEC Rules Governing Redeemable and Treasury Shares, § 3(1) (1982)

⁵ *Id.* § 3(1)(a)

and conditions stated in the articles of incorporation and the certificate of stock representing said shares,, subject to the rules and regulations issued by the Commission."⁶

In addition, Section 5(5) of the 1982 Rules states that "*redeemable shares may be redeemed, regardless of the existence of unrestricted retained earnings*, provided that the corporation has, after such redemption, sufficient assets in its books to cover debts and liabilities inclusive of capital stock."⁷

In short, although the general rule is that there must be unrestricted retained earnings before a corporation can redeem, repurchase, or reacquire its own shares, the exception is when the shares to be redeemed are redeemable as provided in the articles of incorporation and certificates of stock of the corporation. But to redeem said shares, there must be sufficient assets to cover the debts and liabilities of the corporation, as discussed hereunder.

As to your second query, please be advised that as a matter of policy, the Commission refrains from rendering opinion on matters which require determination of factual issues.⁸ Considering that the matter of insolvency require determination of factual issues, the Commission shall refrain from categorically answering the same.

However, for purposes of information only, the following may be imparted.

The right to redeem shares is subject to the condition that the redemption would not render the corporation insolvent, and that the corporation has sufficient funds to satisfy its debts and liabilities. While a corporation, under its articles of incorporation, is allowed to redeem, this is still subject to applicable and existing laws, terms and conditions, and must also not be in violation of the trust fund doctrine.⁹

The Supreme Court had already ruled that "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

⁶ The Revised Corporation Code of the Philippines (exact reproduction of Section 8 of The Corporation Code of the Philippines, Batas Pambansa Blg. 68)

⁷ SEC Rules Governing Redeemable and Treasury Shares, § 5(5) (1982)

⁸ Section 5.8, SEC Memorandum Circular No. 15, series of 2003

⁹ SEC Opinion dated 25 June 1991 addressed to Mr. Jess G. Tabora

corporation is insolvent or if such redemption will cause insolvency or inability of the corporation to meet its debts as they mature."¹⁰

Moreover, for the protection of the stockholders, the 1982 Rules provide that 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.¹¹ 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.¹²

With regard to your third query, Section 9 of the Code states that "treasury shares are shares of stock which have been issued and fully paid for, but subsequently reacquired by the issuing corporation through purchase, redemption, donation or some other lawful means."¹³ Section 3 of the 1982 Rules is likewise instructive:

"xxx

2. 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, unless otherwise provided in the Articles of Incorporation.**

xxx" (Emphasis ours).

Simply stated, where the articles of incorporation is silent on the reissuable nature of issued redeemable preferred shares, the same shall be considered retired and can no longer be reissued once they are redeemed.¹⁴ However, while they are considered as retired, the same remains in treasury until removed from their treasury status by decreasing the authorized capital stock of the corporation in accordance with Section 38 of the Code.¹⁵

Based on the foregoing, the redeemable shares once redeemed become part of the treasury shares of the corporation. To summarize, there are two types of treasury shares out of the redemption of preferred shares. One is non-reissuable, as when the articles of incorporation is silent on the

¹⁰ Republic v. Agana, 336 Phil. 1-14 (1997)

¹¹ SEC Rules, *supra* Note 7 Section 5.4

¹² SEC Rules, *supra* Note 7 Section 2d.

¹³ CORPORATION CODE, § 9.

¹⁴ Section 3 [2], SEC Rules Governing Redeemable and Treasury Shares

¹⁵ Section 4 [2], SEC Rules Governing Redeemable and Treasury Shares

reissuable nature of the redeemable preferred shares. The same will be considered retired and can no longer be reissued. The retirement of treasury shares of this nature have the effect of decreasing the capital stock of the corporation. The second is reissuable, when the articles of incorporation so provide. Treasury shares of this nature are considered reissuable, not retired, and therefore, will not decrease the capital stock of the corporation.

In the case of Quadriver, its amended articles of incorporation is silent on the reissuable nature of its redeemable preferred shares. Accordingly, once they are redeemed, the same shall be considered retired and are no longer reissuable. In turn, the retirement of the treasury shares corresponding to the redeemed preferred shares have the effect of decreasing the capital stock of the Company.

It shall be understood that the foregoing opinion except that part which has been identified as for informational purpose only is rendered based solely on the facts disclosed in the query and relevant solely to the particular issues raised therein and shall not be used in the nature of a standing rule binding upon the courts, or upon the Commission in other cases of similar or dissimilar circumstances.¹⁶ 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.


CAMILO S. CORREA
General Counsel

¹⁶ SEC Memorandum Circular 2003-15 No. 7.