Republic of the Philippines
Securities and Exchange Commission
SEC Bldg. EDSA, Greenhills, Mandaluyong City

27 May 2010

SEC Opinion No. 10-20
Acquisition of Land by a Corporation; Dividend Distribution Mechanism; Directors' Fees

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Attention: **ATTY. TEODULO G. SAN JUAN, JR.**

Gentlemen:

This refers to your letter dated 11 February 2010 requesting opinion on the following:

I. Whether the proposed ownership structure of BFDC and its subsidiaries ABPC, AEPC and RPISI, is legal and valid, and does not violate the nationality restrictions prescribed by the Philippine Constitution and applicable laws upon land-owning corporations; and

II. Whether the proposed dividend distribution mechanism, director's fees and the guaranteed annual payments to RBFC are likewise valid.

For the purpose of the query, APHC and RBFC are assumed as corporations organized and existing under the laws of the Philippines. APHC is wholly owned by foreign investors. RBFC, on the other hand, is a Philippine corporation at least sixty percent (60%) of its total outstanding and voting capital stock is owned by Filipino citizens.

Under the proposed ownership structure ("Structure") of BFDC, RBFC will own and hold 23,187,500 BFDC Class A common shares with a par value of twenty pesos (P20.00) per share, comprising sixty percent (60%) of the total outstanding and voting capital stock of BFDC. APHC will own and hold 15,458,333 BFDC Class B voting redeemable preferred shares with a par value of two hundred seventy pesos (P270.00) per share, comprising forty percent (40%) of the total outstanding and voting capital stock of BFDC. The Class B redeemable shares shall earn cumulative cash dividends of thirty percent (30%) per annum in accordance with the proposed dividend distribution mechanism.

Under the proposed dividend distribution mechanism of BFDC, unrestricted earnings will be distributed as dividends by BFDC as follows:

a) Beginning on the second year of operations under the Structure and each time dividends are declared out of unrestricted retained earnings ("URE"), dividends declared shall be applied first to the payment of any unpaid cumulative cash dividends of the Class B redeemable preferred shares accruing on years prior to the relevant year;

b) Any amount available for distribution as dividends after the satisfaction of unpaid cumulative cash dividends under the preceding paragraph shall be distributed as dividends in the following manner:

   i) Ten percent (10%) will be distributed between the common and redeemable preferred shareholders on the basis of the outstanding capital stock (i.e. the number of shares) held, thus a ratio of sixty percent (60%) to the Class A common shares and forty percent (40%) to the Class B redeemable preferred shares; and

   ii) Ninety percent (90%) of the amount to be distributed as dividends shall be distributed first to satisfy the thirty percent (30%) cumulative cash dividends of the Class B redeemable shares accruing as of the relevant year. Any excess thereafter shall be distributed on the basis of the outstanding capital stock held, thus a ratio of sixty percent (60%) to the Class A common shares and forty percent (40%) to the Class B redeemable shares.

As part of the proposed ownership structure, RBFC will be entitled to appoint three (3) directors while APHC will be entitled to appoint two (2) directors of BFDC. RBFC's appointees will be Filipino citizens while that of APHC may or may not be Filipino citizens. RBFC's appointed directors will be entitled to compensation, in accordance with the provisions of the Corporation Code.[1]

Beginning on the third year of operations under the Structure and annually thereafter, the total amount to be paid as dividends to RBFC and the compensation of RBFC's directors shall not be less than ten percent (10%) of the amount of RBFC's subscription in BFDC shares, subject always to the availability of URE and provided that compensation to BFDC directors as such shall not exceed the maximum permitted under Section 30 of the Corporation Code.

[1] Batas Pambansa Blg. 68 (1980).

Finally, the classification of shares, the rights of each class of shares and the preference granted to the Class B redeemable preferred shares will be incorporated in the BFDC articles of incorporation.

Query No. 1. Validity of the proposed ownership structure

Section 7, Article XII of the 1987 Constitution sets out the limit of a corporation to acquire land in the Philippines, to wit:

> "Sec. 7. Save in cases of hereditary succession, no private lands shall be transferred or conveyed except to individuals, corporations, or associations qualified to acquire or hold lands of the public domain."

From the foregoing, it may be deduced that only corporations that are qualified under the law shall be allowed to acquire land in the Philippines. The determination of whether a corporation may acquire real estate is laid down in Sections 22 and 23 of Commonwealth Act No. 141[2], which provide:

> "Sec. 22. Any citizen of lawful age of the Philippines, and any such citizen not of lawful age who is a head of a family, and any corporation or association of which at least sixty per centum of the capital stock or of any interest in said capital stock belongs wholly to citizens of the Philippines, and which is organized and constituted under the laws of Philippines, and corporate bodies organized in the Philippines authorized under their charters to do so; may purchase any tract of public agricultural land disposable under this Act, not to exceed one hundred and forty-four hectares in the case of an individual and one thousand and twenty-four hectares in that of a corporation or association, by proceeding as prescribed in this chapter: Provided, That partnerships shall be entitled to purchase not to exceed one hundred and forty-four hectares for each member thereof. But the total area so purchased shall in no case exceed the one thousand and twenty-four hectares authorized in this section for associations and corporations.
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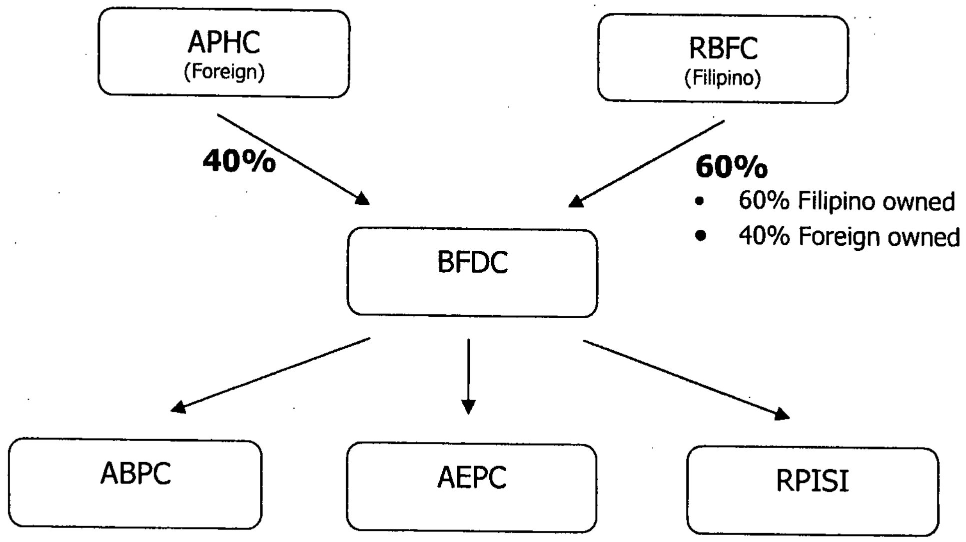
> Sec. 23. No person, corporation, association, or partnership other than those mentioned in the last preceding section may acquire or own agricultural public land or land of any other denomination or classification, which is at the time or was originally, really or presumptively, of the public domain, or any permanent improvement thereon, or any real right on such land and improvement. x x x"

In order for a corporation to purchase, acquire or own land or real estate in the Philippines, it has to comply with the sixty percent (60%) requirement, which means that at least sixty percent (60%) of the total capital stock of the corporation

[2] Otherwise known as The Public Land Act (1936).

must be wholly owned by Filipino citizens.

Pertinent to the query is the diagram of the proposed ownership structure of BFDC as clearly shown below:



Generally, the nationality of a corporation is determined by applying the **control test**[3] which requires:

> "Shares belonging to corporations or partnerships at least 60% of the capital of which is owned by Filipino citizens shall be considered as of Philippine nationality, but if the percentage of Filipino ownership in the corporation or partnership is less than 60%, only the number of shares corresponding to such percentage shall be counted as of Philippine nationality. Thus, if 100,000 shares are registered in the name of a corporation or partnership at least 60% of the capital stock or capital respectively, of which belong to Filipino citizens, all of the said shares shall be recorded as owned by Filipinos. x x x" (underscoring supplied)

However, in cases where a corporation invests in the formation of a new corporation as a stockholder, when there is doubt as to the actual extent of Filipino equity in the investee corporation, the Commission is not precluded from using the **Grandfather Rule**. The "grandfather rule" is the method by which the percentage of Filipino equity in a corporation engaged in nationalized and/or partly nationalized areas of activities, provided for under the Constitution and other nationalization laws, is computed, in cases where corporate shareholders are present in the situation, by attributing the nationality of the second or even subsequent tier of ownership to determine the nationality of the corporate shareholder.[4]

Considering that the material facts in the query are generally hypothetical,

[3] Enunciated in DOJ Opinion No. 18 series of 1989, dated 19 January 1989.
[4] C. Villanueva, PHILIPPINE CORPORATE LAW, 54 (2001 Edition).

the control test shall be applied. From the foregoing illustration, BFDC shall be considered as a Philippine national since the sixty percent (60%) required Filipino ownership is complied with. Applying the control test, all the shares of RBFC shall be considered and recorded as owned by Filipinos in the determination of the nationality of BFDC. Thus, the Filipino ownership in BFDC shall be sixty percent (60%) derived from RBFC's investment and forty percent (40%) foreign ownership derived from APHC shares. Consequently, BFDC shall be allowed to acquire land in the Philippines.

Query No.2. Validity of the proposed dividend distribution mechanism, director's fees and the guaranteed annual payments to RBFC

Under the proposed dividend distribution mechanism, the order of the distribution of the URE is summarized as follows:

1. Payment of any unpaid cumulative cash dividends of the Class B redeemable preferred shares accruing on years prior to relevant year;

2. After the satisfaction of Item 1, the distribution of dividends shall be as follows:

    a. 10% - common and redeemable preferred shares to be divided as 60% to the Class A common shares and 40% Class B redeemable preferred shares;

    b. 90% - shall be distributed in the following manner:

        i. Satisfaction of 30% cumulative cash dividends of the Class B redeemable preferred shares accruing as of the relevant year;

        ii. The excess, if any, shall be distributed on the basis of 60% to the Class A common shares and 40% Class B redeemable preferred shares.

The Corporation Code expressly recognizes the freedom and power of a corporation to classify shares. Under Section 6[5] of the Corporation Code, the shares

[5] Sec. 6. Classification of shares. - The shares of stock of stock corporations may be divided 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 articles of incorporation: Provided, That no share may be deprived of voting rights except those classified and issued as "preferred" or "redeemable" shares, unless otherwise provided in this Code: Provided, further, That there shall always be a class or series of shares which have complete voting rights. Any or all of the shares or series of shares may have a par value or have no par value as may be provided for in the articles of incorporation: Provided, however, That banks, trust companies, insurance companies, public utilities, and building and loan associations shall not be permitted to issue no-par value shares of stock.

Preferred shares of stock issued by any corporation may be given preference in the distribution of the assets of the corporation in case of liquidation and in the distribution of dividends, or such other preferences as may be stated in the articles of incorporation which are not violative of the provisions of this Code: Provided, That of stock of stock corporations may be divided into classes or series of shares, or both, any of which classes or series of shares may have rights, privileges, or restrictions as may be stated in the articles of incorporation.[6]

In considering the proposed dividend distribution system, the entitlement of certain kind of stocks to preferences and benefits must be clearly and expressly stated in the articles of incorporation of BFDC. Under the doctrine of equality of shares — all stocks issued by the corporation are presumed equal with the same privileges and liabilities, provided that the Articles of Incorporation is silent on such differences.[7] The Corporation Code does not grant benefits to a share unless expressly provided for in the articles of incorporation. The classification of shares as "preferred" without indicating what preferential rights they are accorded, would not give such preferred shares any right in addition to those enjoyed by common shares unless expressly provided in the articles of incorporation.

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preferred shares of stock may be issued only with a stated par value. The board of directors, where authorized in the articles of incorporation, may fix the terms and conditions of preferred shares of stock or any series thereof: Provided, That such terms and conditions shall be effective upon the filing of a certificate thereof with the Securities and Exchange Commission.

Shares of capital stock issued without par value shall be deemed fully paid and non-assessable and the holder of such shares shall not be liable to the corporation or to its creditors in respect thereto: Provided; That shares without par value may not be issued for a consideration less than the value of five (P5.00) pesos per share: Provided, further, That the entire consideration received by the corporation for its no-par value shares shall be treated as capital and shall not be available for distribution as dividends.

A corporation may, furthermore, classify its shares for the purpose of insuring compliance with constitutional or legal requirements.

Except as otherwise provided in the articles of incorporation and stated in the certificate of stock, each share shall be equal in all respects to every other share.

Where the articles of incorporation provide for non-voting shares in the cases allowed by this Code, the holders of such shares shall nevertheless be entitled to vote on the following matters:

1. Amendment of the articles of incorporation;
2. Adoption and amendment of by-laws;
3. Sale, lease, exchange, mortgage, pledge or other disposition of all or substantially all of the corporate property;
4. Incurring, creating or increasing bonded indebtedness;
5. Increase or decrease of capital stock;
6. Merger or consolidation of the corporation with another corporation or other corporations;
7. Investment of corporate funds in another corporation or business in accordance with this Code; and
8. Dissolution of the corporation.

Except as provided in the immediately preceding paragraph, the vote necessary to approve a particular corporate act as provided in this Code shall be deemed to refer only to stocks with voting rights.

[6] R. Villnueva, PHILIPPINE CORPORATE LAW, 538 (2001 Edition).
[7] Commissioner of Internal Revenue vs. CA, et al., G.R. No. 108576, January 20, 1999.

With regard to the appointment of directors of BFDC, RBFC and APHC may **nominate**, not appoint, three (3) directors and two (2) directors respectively to the Board of Directors of BFDC. In the letter-query, it is indicated that APHC's two (2) appointees may or may not be Filipino citizens. Pursuant to the Anti-Dummy Law,[8] the election of an alien to the board of directors may be allowed as long as the corporation is not engaged in a wholly nationalized activity and only in proportion to their share in the capital of such corporation.

Anent the issue on the director's fees, the directors of BFDC may be entitled to compensation in accordance with Section 30 of the Corporation Code, which provides:

> "Sec. 30. Compensation of directors. - In the absence of any provision in the by-laws fixing their compensation, the directors shall not receive any compensation, as such directors, except for reasonable per diems: Provided, however, That any such compensation other than per diems may be granted to directors by the vote of the stockholders representing at least a majority of the outstanding capital stock at a regular or special stockholders' meeting. In no case shall the total yearly compensation of directors, as such directors, exceed ten (10%) percent of the net income before income tax of the corporation during the preceding year."

From the foregoing provision of law, the directors shall not receive any compensation with respect to their duties as directors except for reasonable per diems. However, they may be entitled to compensation if there is a provision in the by-laws fixing such compensation. Also, the directors may be granted compensation, aside from per diems, by the vote of the stockholders representing at least a majority of the outstanding capital stock at a regular or special stockholders' meeting. The compensation of directors is further subject to the condition that the total yearly compensation of directors shall not exceed ten percent (10%) of the net income before income tax of the corporation during the preceding year. Thus, the compensation of the directors of BFDC shall be valid as long as the requirements under Section 30 are duly complied with.

Finally, with respect to the guaranteed payments to RBFC and its directors, considering the facts presented in the letter-query regarding such guaranteed payments, the Commission opines that the proposal is likewise valid and can be implemented by BFDC without violating the Corporation Code.

The foregoing opinion rendered is 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 Commission. If upon investigation, it will be disclosed that the facts relied upon are different, this opinion shall be rendered null and void.

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[8] Commonwealth Act No. 108, as amended by P.D. 715.

Very truly yours,

VERNETTE G. UMALI-PACO
General Counsel