Republic of the Philippines
Department of Finance
Securities and Exchange Commission

OFFICE OF THE GENERAL COUNSEL

February 14, 2019

SEC-OGC Opinion No. 19-03
RE: Computation of Retained Earnings Available for Dividend Declaration

ATTY. BENEDICTO PANIGBATAN
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Dear Sir:

This refers to your letter requesting confirmation that a cash dividend declaration based on the amount of unrestricted retained earnings without deducting the cost of treasury shares acquired from the redemption of redeemable preferred shares (as provided for in the articles of incorporation) is valid.

Your letter states that a corporation (the "Declaring Corporation") has unrestricted retained earnings and treasury shares arising from the redemption of its 'Preferred Redeemable Shares' as recognized in its Articles of Incorporation ("AOI"). The Declaring Corporation is proposing to declare cash dividends. The unrestricted retained earnings of the declaring corporation is sufficient to support the dividend declaration provided that the treasury shares arising from the redemption of the shares will not be deducted. Given this situation, your letter asks whether the cash dividend declaration based on the unrestricted retained earnings ***gross*** of the treasury shares from the redemption of preferred redeemable shares shall be held invalid for insufficiency of unrestricted retained earnings..

The opinion hinges on the continued effectivity of the "Rules Governing Redeemable and Treasury Shares" (1982 Rules) issued in 1982 and on the applicability of the exception in the same 1982 Rules with regard to the computation of restricted retained earnings as provided for in the SEC Memorandum Circular No. 11, series of 2008 or the "Guidelines on the Determination of Retained Earnings Available for Dividend Declaration" (2008 Guidelines).

Based on the 1982 Rules and 2008 Guidelines, there appears to be a difference in the determination of unrestricted retained earnings for the purpose of dividend declaration particularly in the treatment of treasury shares. While the

1982 Rules provides that the cost of treasury shares acquired from the redemption of redeemable shares need not be deducted from the unrestricted retained earnings and need not be restricted from being declared and issued as dividends, the 2008 Guidelines includes treasury shares (in general) as an item that is subtracted from the net income earned in order to determine 'Retained Earnings Available for Dividend Declaration'. The said 2008 Guidelines make no distinction as to the circumstances surrounding the acquisition of treasury shares.

Given the silence of the 2008 Guidelines regarding the exemption, your letter now asks for confirmation that the exemption, as embodied in the 1982 Rules, remains applicable thus, the cost of treasury shares arising from the redemption of redeemable shares as provided for in the AOI need not be considered and subtracted in the computation for determination of the corporation's 'Retained Earnings Available for Dividend Declaration'.

The Commission confirms the requestor's position.

For dividend declaration, "the board of directors of a stock corporation ***may declare dividends out of the unrestricted retained earnings***"[1] "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. Hence, any disposition of corporate funds to the prejudice of creditors is null and void. Creditors of a corporation have the right to assume that so long as there are outstanding debts and liabilities, the board of directors will not use the assets of the corporation to purchase its own stock."[2] On this premise, "the declaration of dividends is dependent upon the availability of surplus profit or unrestricted retained earnings, as the case may be."[3]

As to the reconciling items of the unrestricted retained earnings, the 1982 SEC Rules Governing Redeemable and Treasury Shares Section 4(1) provides that "*the amount of unrestricted retained earnings equivalent to the cost of the treasury shares being held, other than those acquired in accordance with the exceptions provided in Section 3(1) of these rules, shall be restricted from being declared and issued as dividends.*"[4] Section 3(1) stating 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, except: 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*

[1] Corporation Code of the Philippines, Sec. 43.
[2] Turner v Lorenzo Shipping Corporation, GR 157479.
[3] Republic Planters Bank v Agana, GR 51765, March 3, 1997.
[4] SEC Rules Governing Redeemable and Treasury Shares (1982), Section 4(1).

provided for in its articles of incorporation and certificates of stock representing said shares of the corporation, in accordance with the provisions expressly provided for in its articles of incorporation and certificates of stock representing said shares; "[5]

Given the aforementioned provisions, the 1982 Rules explicitly provides that generally, treasury shares shall be deducted from the unrestricted retained earnings to arrive at the 'Retained Earnings Available for Dividend Declaration'. "The reason for this is that such amount of earnings equivalent to the cost of treasury shares is not considered part of earned or surplus profits that is distributable as dividends."[6] Also under the same 1982 rules, an exception has been drawn under section 4(1) in relation to section 3(1). Under the provided exception, redeemed redeemable shares, although part of the treasury shares, is not subtracted from the unrestricted retained earnings to arrive at the 'Retained Earnings Available for Dividend Declaration'.

On the other hand, 2008 Guidelines, annex "A" and SEC Rule 68, annex "C" provided for the computation of the 'Retained Earnings Available for Dividend Declaration'. Under both annexed guide formulae, treasury shares have been deducted from the unrestricted retained earnings in order to arrive at the 'Retained Earnings Available for Dividend Declaration', in which no qualification as to the type and source of the treasury shares has been provided. There is also no exemption provided for under the 2008 Guidelines and under SEC Rule 68.

While there may be a seeming conflict, the two can be harmonized following the rules on statutory construction. As much as possible, laws or rules should be interpreted such that both are rendered effective, except when they are actually inconsistent, such that one operates to repeal the other.[7] Reconciling the 1982 rules and the later guidelines, the 2008 Guidelines, although silent as to any exemption as to the deductibility of treasury shares, did not repeal the explicit pronouncement of the 1982 Rule for the following reasons:

First, the 1982 Rules, although issued more than two decades ago, continue to apply in the computation of unrestricted retained earnings for dividend declaration and remain significant insofar as the exemption of the particular items. Considering that Section 3(1) recognizes the special nature of treasury shares in the form of redeemed redeemable shares. The exception (or non deduction) is based on the nature of redeemable shares.

"Redeemable shares may be issued by the corporation when expressly so provided in the articles of incorporation. They may be purchased or taken up by the corporation upon the expiration of a fixed period, regardless of the existence

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[5] SEC Rules Governing Redeemable and Treasury Shares (1982), Section 3(1).
[6] SEC-OGC Opinion No. 12-06, April 20, 2012.
[7] Rosario Valera vs. Mariano Tuason, Jr., GR No. L-1276, April 30, 1948.

of unrestricted retained earnings in the books of the corporation."[8] Given such, a corporation may not redeem its shares unless there is adequate retained earnings.[9] However, due to the special nature of a redeemable share as provided for in the AOI, **adequate amount of unrestricted retained earnings is not necessary for its redemption provided that corporation has, after such redemption** ***sufficient assets in its books to cover debts and liabilities inclusive of capital stock."***[10] Hence the exception should be read with Section 5(5) of the same 1982 Rules. "The present Code allows redemption of shares even if there are no unrestricted retained earnings on the books of the corporation. This is a new provision which in effect qualifies the general rule that the corporation cannot purchase its own shares except out of current retained earnings."[11] "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."

With this rationale in mind, the exception of Rule 3(1) will only apply subject to the sufficiency of assets in its books to cover debts and liabilities inclusive of capital stock. Given that the reason for the unrestricted of retained earnings for dividend declaration is the trust fund doctrine in order to protect the creditors, having the exception under the 1982 Rules under section 4(1) in relation to section 3(1) which presupposes a sufficient assets (despite lack of unrestricted retained earnings), there is no need for deductibility of treasury shares arising from said exception as the redemption of said shares will not detriment the creditors.

Second, there is no conflict between the general guide formula as provided for in 2008 Guidelines and the explicit exception under the 1982 Rules. ""It is well settled that a special and local statute or rules, providing for a particular case or class of cases, is not repealed by a subsequent statute or rule, *general in its terms, provisions and application*, unless the intent to repeal or alter is manifest, although the terms of the general act are broad enough to include the cases embraced in the special law."[12] Under this premise, the repealing provision[13] under the 2008 Guidelines, did not repeal previous guidelines and rules of the commission which are not in conflict with the current rules. In this regard, it is

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[8] Corporation Code of the Philippines, Section 8.
[9] SEC Rules Governing Redeemable and Treasury Shares (1982), Section 3(1).
[10] SEC Rules Governing Redeemable and Treasury Shares (1982), Section 5(5).
[11] Republic Planters Bank v Agana, GR 51765, March 3, 1997.
[12] Manila Railroad Company v Rafferty, GR 14205, September 30, 1919 citing (McKenna *vs.* Edmundstone (91 N.Y., 231)).
[13] Sec. 7: All existing guidelines of the Commission currently in force and effect that may be in conflict with these guidelines on the determination of unrestricted retained earnings available for dividend declaration are herby repealed, modified or amended accordingly.

appropriate to note that the 2008 Guidelines, although making no distinction as to the manner in which treasury shares are acquired, only enumerates "treasury shares" as one of the items affecting the unrestricted retained earnings account from an accounting perspective. It does not specifically state that all types of treasury shares, regardless of the nature of their acquisition, should be deducted from the unrestricted retained earnings to arrive at the 'Retained Earnings Available for Dividend Declaration'. In this regard, no conflict is present.

As a summary, the annexes in the 2008 Guidelines and SEC Rule 68 should be read in harmony with the 1982 Rules. To answer your query, the cost of treasury shares acquired from the redemption of redeemable shares is not deducted; rather, it forms part of the 'Retained Earnings Available for Dividend Declaration'. In effect, a dividend declaration from the unrestricted retained earnings **gross** of the cost of redeemed preferred shares acquired pursuant to the AOI is considered as valid.

It shall be understood that the foregoing opinion 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.[14] 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.

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