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

SAN MIGUEL FOODS, INC.,
Appellant,

-versus-

BENITO A. CATARAN, in his capacity as Director of the COMPANY REGISTRATION AND MONITORING DEPARTMENT,
Appellee.

SEC En Banc Case No. 12-09-185
For: Review of CRMD's Letter-Ruling Re: Application of the Rules Regulating the Issuance of Property Dividends

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DECISION

For consideration is the *Appeal* of San Miguel Foods, Inc. ("SMFI", for brevity) dated 1 December 2009 filed on 11 December 2009 from the 11 November 2009 letter-ruling of the Commission's Company Registration and Monitoring Department ("CRMD") denying the letter-request filed by SMFI for the reconsideration of CRMD's imposition of One Million Six Hundred Forty-Five Thousand Seven Hundred Thirty-One Pesos (P1,645,731.00) for the company's violation of the *Rules Regulating the Issuance of Property Dividends* ("the *Rules*")[1].

The facts are:

SMFI is a wholly-owned direct subsidiary of San Miguel Pure Foods Co., Inc. ("SMPFC"). San Miguel Mills, Inc. ("SMMI") is a wholly-owned direct subsidiary of SMFI and is, thus, a wholly-owned indirect subsidiary of SMPFC.[2]

The San Miguel Group of Companies undertook a restructuring of its Food Group with the objective that all its operating companies engaged in the food or food-related business, save for Monterey Foods Corporation, become wholly-owned direct subsidiaries of SMPFC. The final step in this restructuring was to dividend up the shares of SMFI in SMMI ("SMMI Shares") in favor of SMPFC to make SMMI a wholly-owned direct subsidiary of SMPFC. Accordingly, SMFI declared its SMMI Shares as property dividends in favor of its stockholder, SMPFC.[3]

On 11 October 2007, SMFI filed with the CRMD its application for a Certificate of Dividend Declaration relating to the SMMI Shares ("SMFI Application"). In the processing of the SMFI Application, it was found out that in March 2007, SMMI increased its authorized capital stock of which the only subscriber was SMFI for

[1]Dated 9 June 1992.
[2]Memorandum of Appeal, p. 1.
[3]Ibid., p. 2.

16,454,816 shares of stock. Since SMFI fully paid its subscription by way of net assets of its Flour Division (i.e., receivables, land and transportation equipment), the shares of SMFI were held in escrow. These shares of stock are the ones declared by SMFI as property dividends. Thus, the approval of the SMFI Application was held in abeyance pending release of the shares from escrow.

On 3 January 2008, a Deed of Assignment of the SMMI Shares was executed by SMFI and SMPFC in favor of the latter.

Thereafter, SMFI submitted its 2007 and 2008 Audited Financial Statements ("AFS") wherein the SMMI Shares were no longer reflected in the investment account of SMFI.[4]

In its letter dated 29 July 2009[5], CRMD penalized SMFI a penalty of One Million Six Hundred Forty-Five Thousand Seven Hundred Thirty-One Pesos (P1,645,731.00) for actually distributing the SMMI Shares prior to the Commission's approval of the SMFI Application, as evidenced by the execution of the Deed of Assignment and the removal of the SMMI Shares in the investment account reported in SMFI's 2007 and 2008 AFS, in violation of the *Rules.*

SMFI sought reconsideration of the said imposition of penalty[6], which, however, was denied by the CMRD through its letter-ruling dated 11 November 2009.[7]

Hence, this *Appeal.*

The ultimate issue to be resolved is whether SMFI actually distributed the SMMI Shares as property dividends prior to the approval by the Commission of the SMFI Application, thereby violating the *Rules.*

Section 43 of the Corporation Code ("the Code")[8] is clear: declaration of dividends, whether it be cash, stock or **property**, can be allowed only when the corporation has sufficient and unrestricted retained earnings.[9] Besides this primary condition, property dividends are allowed only under any of the following circumstances: (1) when the property is no longer intended to be used in the operation of the business and it is practicable to distribute the same to stockholders,

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[4]Supra Note 1, p. 4. See also Annex "9-A", Memorandum of Appeal.
[5]Annex "6", Memorandum of Appeal.
[6]See SMFI's letter-request dated 13 August 2009 (Annex "7", Memorandum of Appeal).
[7]Annex "8", Memorandum of Appeal.
[8]Batas Pambansa Bilang 68 (1980).
[9]*SEC Opinion dated 12 May 1983 addressed to Phinma Realty Corporation;* SEC Opinion dated 23 September 1986 addressed to Valdes, Asuncion, Gomez and Associates.

or (2) as liquidating dividends.[10] Further, the issuance of the property dividends shall not result in an inequitable distribution of property to the stockholders in terms of the book values and market values, if any, of the property distributed.[11]

The above considerations are all embodied in the *Rules*, which, accordingly, mandates that "*no actual distribution of property dividends shall be made unless approved by the Commission.*"[12]

In the main, SMFI argues that there was no actual distribution of the SMMI Shares because there was no valid transfer of the said shares, there having been no delivery and endorsement of the corresponding certificates of stock to SMPFC. SMFI anchors this argument on Section 63 of the Code, which states:

> "Sec. 63. *Certificate of stock and transfer of shares.* – xxx. Shares of stock so issued are personal property and ***may*** be transferred **by delivery of the certificate or certificates indorsed by the owner or his attorney-in-fact or other person legally authorized to make the transfer**. No transfer, however, **shall** be valid, ***except as between the parties***, until the transfer is recorded in the books of the corporation so as to show the names of the parties to the transaction, the date of the transfer, the number of the certificate or certificates and the number of shares transferred." (Emphasis ours).

and in the case of *Rural Bank of Lipa City, Inc. vs. Court of Appeals.*, which allegedly prescribes delivery and indorsement of the certificate of stock as the only valid means of transfer of shares, even as between the parties.[13]

We are not persuaded.

SMFI's invocation of *Rural Bank of Lipa City, Inc.* is misplaced. A careful reading of the case reveals that the real issue therein was whether the Hearing Officer abused his discretion in issuing (1) the writ of preliminary injunction enjoining therein respondents from acting as directors and officers of the bank, (2) the temporary restraining order preventing therein respondents from holding the bank's 1995 stockholders' meeting and election of directors and officers. In short, the real issue goes into the legality or propriety of the issuance of the said provisional remedies rather than on the question of when transfer of shares, or what mode of transfer, is valid.

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[10]SEC Opinion dated 5 February 1991 addressed to Mr. Benjamin L. Gregori.
[11]Section 2, the *Rules*.
[12]Section 4, the *Rules*.
[13]G.R. No. 124535, 28 September 2001.

In the consolidated cases of *Batangas Laguna Tayabas Bus Company, Inc., et al. vs. Bitanga, et al.*[14] and *Danilo L. Concepcion, et al. vs. Court of Appeals, et al.*[15], the respondents filed a motion for reconsideration with the Supreme Court ("SC") praying that the SC's pronouncements regarding the validity of the transfer of ownership of shares be reconsidered because the subject matter of the petitions was only the propriety of the issuance of a writ of preliminary injunction, and not the validity of the transfer, which had yet to be decided by the court below. The SC clarified that it was not its intention to prejudge the issue of whether or not there was a valid transfer of ownership of shares. It said that although the language of its main decision may have seemed categorical, its ruling on the validity of the transfer of shares should be understood in relation to the grant of the preliminary injunctive writ, which is just a provisional remedy, and should in no way be interpreted to mean as a resolution of the main cases pending with the trial court.[16]

Accordingly, *Rural Bank of Lipa City, Inc.* is not a definitive authority to support SMFI's claim that a transfer of shares of stock is valid, even as between the parties, only when the certificates of stock are delivered and endorsed to the transferee or assignee.

There is, however, definitive authority to support the contrary view. In *Tan vs. Securities and Exchange Commission, et al.*[17], this issue came up: whether Section 63 of the Code is mandatory in nature, such that when a transfer of shares is not attended by the actual delivery and endorsement of the corresponding certificate of stock, such transfer is null and void. **Citing previous case(s), the SC held that the word "*may*" in Section 63 indicates that the transfer may be effected in a manner different from that provided for in the law.** The SC also stated that delivery is not even essential where it appears that the persons sought to be held as stockholders are officers of the corporation, and have the custody of the stock and transfer book.

The above ruling that there can be a valid transfer of shares through other modes, even without the delivery and endorsement of the certificate of stock, is recognized and accepted by most legal experts in corporate law.[18] While it is usual to effect the transfer of shares by indorsement on the certificate, a conveyance may be made by an assignment or sale in a separate instrument[19] in lieu of the indorsement of the certificate, unless the by-laws expressly provide that the transfer

[14]G.R. No. 137934.
[15]G.R. No. 137936.
[16]Resolution dated 19 September 2005 in the consolidated cases of G.R. No. 137934 and G.R. No. 137936.
[17]G.R. No. 95696, 3 March 1992.
[18]Cesar L. Villanueva, Philippine Corporate Law 426 (2001 Edition); Hector S. De Leon, The Corporation Code of the Philippines Annotated 564 (2002 Edition); Rosario N. Lopez, The Corporation Code of the Philippines Annotated 807 (1994).
[19]Hector S. De Leon, The Corporation Code of the Philippines Annotated 565 (2002 Edition), citing Uy Piaco vs. McMicking, 10 Phil. 286.

shall be made exclusively in the manner authorized by the statute.[20] In fact, a formal contract of purchase and sale set in a notarial document is equivalent to the actual delivery[21] and indorsement[22] of the certificate. However, and this is the mandatory part of Section 63, the transfer of ownership, while valid between the parties, will be valid as to the corporation and third persons only when the same is finally recorded in the corporate books.[23]

The foregoing is consistent with the doctrine of free transferability of shares. Shares of stock are personal property, and it is well-settled that the owner, as in the case of other personal property, has an absolute and inherent right, as incident of his ownership, to sell and transfer the same at will, except insofar as the right may be restricted by the charter of the corporation or the general law, provided the transfer is in good faith, and to a person capable of assuming the obligations of a stockholder.[24] Being interests in a corporation, shares of stock are essentially incorporeal or intangible property. As such, their transfer is, as it should be, generally and practically freely allowed, which free transferability, however, would be effectively defeated if the only mode of transfer is by delivery and indorsement of the certificate(s) of stock.[25] In this connection, an incorporeal property may be sold through a public instrument and the execution of such instrument shall be equivalent to the delivery of the thing which is the object of the contract, if from the deed the contrary does not appear or cannot clearly be inferred.[26]

On the other hand, a certificate of stock is not stock in a corporation; it is a mere paper representative or tangible evidence of the stockholders' interest in the corporation, his ownership of the share(s) represented thereby, but is not in law the equivalent of such ownership. It is not necessary to render one a stockholder in a corporation.[27]

Further, *Rural Bank of Lipa City, Inc.* is not squarely *apropos* because the real issue in the case at bar, as mentioned, is whether there was actual distribution of the SMMI Shares prior to the approval of the SMFI Application. Indeed, from the point of view of the regulator, the operative act should be the divestment of ownership over the SMMI Shares by assignor SMFI, and not the acquisition *per se* of ownership by the assignee SMPFC.

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[20]Supra, Note 19, citing Fisher. In this connection, SMFI's by-laws merely adopt the provisions of Section 63 on the matter, likewise using the word "*may*".
[21]Rosario N. Lopez, The Corporation Code of the Philippines Annotated 807 (1994), likewise citing Uy Piaco vs. McMicking, 10 Phil. 286.
[22]Supra, Note 20.
[23]Supra, Note 21.
[24]SEC Opinion No. 22-05 dated 12 December 2005 addressed to Mr. Artemio F. Dulay.
[25]Supra, Note 17.
[26]Article 1501, in relation to Article 1498, of the New Civil Code of the Philippines.
[27]Supra, Note 17.

At any rate, the records establish that there was transfer of ownership of the SMMI Shares from SMFI to SMPFC.

The notarized Deed of Assignment between SMFI and SMFPC[28] states:

> "1. Pursuant to the property dividend declaration covering the SMMI Shares made by the Assignor in favor of the Assignee, the Assignor hereby ***absolutely and irrevocably assigns, transfers, and conveys*** in favor of the Assignee ***all of the Assignor's rights, title, and interest over the SMMI Shares***, free from all liens and encumbrances of any nature and kind.
>
> 2. The parties agree that ***this Deed shall be given retroactive effect to December, 2007 (the 'Effective Date')*** and ***the Assignee shall therefore be the beneficial owner of the SMMI Shares from the Effective Date***. The Assignee further acknowledges that **the assignment** of the SMMI Shares **shall be recorded in the books** of SMMI **only upon the issuance** by the Securities and Exchange Commission of the relevant Certificate of Filing of Property Dividend Declaration and by the Bureau of Internal Revenue of the relevant Certificate Authorizing Registration." (Emphasis ours).

SMFI's argument, i.e. that there is as yet no distribution of the SMMI Shares because the Deed of Assignment expressly states that the assignment would only be recorded in the books of SMMI upon approval by the Commission of the SMMI Application, is unavailing. Based on the unequivocal terms of the Deed of Assignment, SMFI already absolutely and irrevocably assigned, transferred and conveyed to SMPFC all of its rights, title and interest over the SMMI Shares. What was subject to the suspensive condition that consists of the approval of the SMFI Application is not the transfer of the shares itself, but the recording of the assignment in SMMI's books. This is why pending such recording, assignee SMPFC is called the beneficial owner of the SMMI Shares, with SMFI being the legal owner holding such shares in trust for SMPFC.

As required documentary attachment to the SMFI Application filed on 11 October 2007, SMFI's 2006 AFS[29] was submitted to the Commission, which clearly listed the SMMI Shares as part of the company's assets. After the Deed of Assignment was executed on 3 January 2008, the SMMI Shares were no longer reflected as assets of SMFI in the investment account of the company's AFS for the period ending 31 December 2008.[30] This confirms that there was already transfer of ownership over the SMMI Shares from SMFI to SMPFC.

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[28] Annex "2", Memorandum of Appeal.
[29] Annex to the SMFI Application, which is Annex "1" of the Memorandum of Appeal.
[30] Annex "9-A", Memorandum of Appeal.

SMFI downplays the removal of the SMMI Shares as assets of the company in its AFS covering the period ending 31 December 2008 by arguing that the pendency of the SMFI Application with the Commission was sufficiently disclosed in the Notes to such AFS, as well as in the notes to SMMI's AFS for the period ending 31 December 2008.[31] Such disclosures, however, do not negate the fact that the SMMI Shares were already transferred. There is nothing in the Notes to these AFS's that categorically makes the transfer subject to the above-referred suspensive condition such that it would contravene the clear terms of the Deed of Assignment. On the contrary, the afore-mentioned AFS of SMMI declares, in no uncertain terms, that "*the execution of the Deed of Assignment effectively makes the Company a wholly-owned subsidiary of SMPFC as of December 28, 2007.*"[32]

At the time the Deed of Assignment and the said AFS's were executed, the SMFI Application was not yet approved by the Commission.

It is, thus, established that SMFI actually distributed the SMMI Shares by assigning the same to SMPFC prior to the approval of the SMFI Application. As beneficial owner of the SMMI Shares as of 28 December 2007, SMPFC already has ownership rights appurtenant to such shares, including the right to compel SMFI to execute acts pursuant to the Deed of Assignment that would enable it to exercise full rights over the shares.[33] Such right to compel may not, however, be necessary and/or difficult to enforce because SMFI is a wholly-owned direct subsidiary of SMFPC, and is therefore effectively controlled by the latter. Pursuant to *Tan* as above-cited, this relationship of SMFI and SMPFC further makes delivery of the certificates of stock covering the SMMI Shares inessential because the person sought to be held as stockholder, SMPFC, is the parent company of, and thereby exercising effective control over, SMFI.

As aptly put by CRMD, if SMFI recognizes the significance and rationale for the approval of the Commission of applications for declaration of property dividend declaration, then it should neither divest itself of even beneficial rights to such shares (as it would already be parting away with its full dominion over the shares, and at the same time making itself liable in one way or another to the transferee) nor remove in its corporate books such shares as part of its assets. Otherwise, the approval of the Commission of such application would, indeed, be just a formality consummating the act of the corporation.

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[31] Annex "9", *Memorandum of Appeal*.
[32] Ibid.
[33] Supra, Note 16.

In the same vein that the SC, in *Tan*, abhorred the manipulation of Section 63 consisting of petitioner's contumacious withholding of the certificate of stock[34], we cannot countenance the use of the same provision to violate or circumvent our rules.

WHEREFORE, premises considered, the instant *Appeal* is hereby **DISMISSED**, and herein assailed ruling of the Company Registration and Monitoring Department is hereby **AFFIRMED.** San Miguel Foods, Inc. is hereby directed to pay the penalty of One Million Six Hundred Forty-Five Thousand Seven Hundred Thirty-One Pesos (P1,645,731.00) for violation of the *Rules Regulating the Issuance of Property Dividends*, within ten (10) days from receipt hereof.

SO ORDERED.

Mandaluyong City, 11 November 2010.

PE B. BARIN
Chairperson

MA. JUANITA E. CUETO
Commissioner

RAUL J. PALABRICA
Commissioner

MANUEL HOBERTO B. GAITE
Commissioner

ELADIO M. JALA
Commissioner

[34]Supra, Note 17.