Republic of the Philippines
Department of Finance
Securities and Exchange Commission
PICC Secretariat Building, PICC Complex, Pasay City

COMMISSION EN BANC

PACIFIC STAR PROPERTIES, INC.
Appellant,

- versus -

SEC En Banc Case No. 10-10-216

COMPANY REGISTRATION AND MONITORING DEPARTMENT,
Appellee.
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DECISION

This is an Appeal of the Letter-Orders dated 23 July 2010 and 25 August 2010 of the **Company Registration and Monitoring Department (CRMD)**, which revoked Pacific Star Properties, Inc.'s Certificate of Approval of Increase of Authorized Capital Stock.

RELEVANT FACTS

Pacific Star Properties, Inc. (PACIFIC STAR) is a domestic corporation duly-registered with the Commission (SEC Reg. No. A199813548) on 8 September 1998. It had an initial Authorized Capital Stock of PHP 50 Million.

Sometime in 2002, PACIFIC STAR applied for increase its Authorized Capital Stock to PHP 150 Million, where eighteen (18) parcels of land (lots) would be transferred to it by the subscriber,[1] in consideration of the shares.

On **27 July 2004**, the CRMD issued a Certificate of Approval of Increase of Authorized Capital Stock.

On **11 August 2005**, the CRMD issued a Show Cause Order directing PACIFIC STAR to explain why the Certificate of Approval should not be revoked for failure to transfer the 18 lots to PACIFIC STAR's name within the 90-day period from approval prescribed by the SEC Guidelines Covering the Use of Properties that Require Ownership Registration as Paid-up Capital (SEC Guidelines) dated 15 November 1994.

On **21 September 2005**, PACIFIC STAR appeared before the CRMD, alleging that it was having difficulty securing the Bureau of Internal Revenue (BIR) Tax Clearance for the property-for-stock transaction, as it paid the property taxes at the wrong BIR venue.

The CRMD directed PACIFIC STAR to submit a Report on the reason for the delay, but it did not file such a report.

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[1] Dolmar Real Estate Development Corporation

On **13 February 2009**, the CRMD issued another Show Cause Order, which was returned unserved since PACIFIC STAR had changed its address.

On **23 July 2010**, the CRMD issued the first assailed Letter-Order, which revoked PACIFIC STAR's Certificate of Approval of Increase of Authorized Capital Stock, viz.

> Pursuant to the authority to suspend or revoke, after proper notice and hearing, vested in the Securities and Exchange Commission under Batas Pambansa Blg. 68 [The Corporation Code], P.D. 902-A as amended, and other existing laws, the Certificate of Approval of Increase of Authorized Capital Stock approved by the Commission on July 27, 2004 of PACIFIC STAR PROPERTIES, INC. is hereby **REVOKED** for its failure to comply with the conditions set forth in the Commission's Guidelines adopted on November 15, 1994, covering the use of properties that require ownership registration as paid-up capital.[2]

On **13 August 2010**, PACIFIC STAR filed a Motion for Reconsideration with the CRMD, raising *substantial compliance* and *good faith.*

On **25 August 2010**, the CRMD issued the second assailed Letter-Order, which dismissed PACIFIC STAR's Motion for Reconsideration as a prohibited pleading, viz.

> Please be informed that your motion is a prohibited pleading under the 2006 Rules of Procedure of the Securities and Exchange Commission. The proper procedure is to file an appeal with the Commission En Banc pursuant to the said rule.[3]

On **11 October 2010**, PACIFIC STAR filed its Memorandum on Appeal, arguing that:

> (1) It substantially complied with the requirement to transfer title, considering it exerted utmost efforts and **succeeded in transferring title to 17 out of the intended 18 lots**, but was prevented from completing the last transfer by "some legal and technical discrepancies" (*i.e.* payment of property taxes at the wrong BIR venue, and being penalized by the BIR due to such error);[4] and
>
> (2) It was in good faith and **did not "disregard" the Show Cause Order** dated 13 February 2009, as it never received the same.[5]

On **29 October 2010**, the CRMD filed its Reply Memorandum. The CRMD argued that:

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[2] Page 2 of CRMD Letter-Order dated 23 July 2010
[3] CRMD Letter-Order dated 25 August 2010
[4] Pages 4-7 of Memorandum on Appeal
[5] Pages 7-8 of Memorandum on Appeal

> (1) The SEC Guidelines nowhere state that substantial compliance with the required transfer of titles would be sufficient, because **insufficient or partial consideration for shares amounts to watered stock** that is prohibited by law;[6] and
>
> (2) The Show Cause Order was **properly served on the last known address of PACIFIC STAR**, where it was served with the previous orders (However, the CRMD admits that the process served noted "R.T.S. Moved Out 2/20/09").[7]

On **3 June 2017**, PACIFIC STAR filed a Manifestation that it is "ready, willing, and able to substitute cash in lieu of the Subject Title" to the 18th lot (2017 Manifestation).

On **22 May 2018**, PACIFIC STAR filed another Manifestation (2018 Manifestation), expressly stating that it has still only transferred title to 17 out of the 18 lots, viz.

> Meanwhile, the records will bear that except for the property covered by the Subject Title, the seventeen (17) other properties proposed to be conveyed by [Dolmar Real Estate Development Corporation, the subscriber] to [PACIFIC STAR] were successfully and timely transferred to the latter.[8]

Hence this appeal.

DISCUSSION

The only issue is whether or not the CRMD erred in revoking the Certificate of Approval of Increase of Authorized Capital Stock.

The **SEC Guidelines Covering the Use of Properties that Require Ownership Registration as Paid-up Capital of the Corporation (SEC Guidelines) dated 15 November 1994** provides for a 90-day period for transferring title to the corporation [Par. 1.a.], as well as the penalty of revocation of approval if such transfers are not completed within 90 days [Par. 2], viz.

> 1.a. Where the payment is made in the form of land, **the corresponding shares of stock to be issued** thereon shall be held in escrow by the Commission and **shall be released only after proof of the transfer of the certificate of ownership** thereon, in the name of the transferee-corporation, is submitted to this Commission **within ninety (90) days from the date of approval of the application** extendible for justifiable reasons.

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[6] Pages 1-2 of Reply Memorandum
[7] Pages 2-3 of Reply Memorandum
[8] Page 5 of 2018 Manifestation

XXX XXX XXX

> 2. That **the non-submission of the documents above, within the prescribed period**, after due notice and hearing, **shall be sufficient ground for the revocation of the related application approved by the Commission** or for the institution of appropriate action as the Commission may deem fit under the circumstances.

Under the Guidelines, there must be (1) a failure to submit the proof of transfer of ownership within 90 days, and (2) an opportunity to be heard.

The first requirement, Failure to Submit Proof of Transfer, is present. PACIFIC STAR was not able to provide proof of transfer of ownership over all of the lots within the 90-day period, transferring title to only 17 out of the intended 18 lots.

The 18 lots in consideration of an additional PHP 100[9] Million equity only comprises 1 subscription contract, as alleged by PACIFIC STAR itself, and this indivisible obligation was also the basis for the issuance of the certificate of approval of increase in authorized capital stock, viz.

> PACIFIC STAR was incorporated on September 8, 1998 with an initial capitalization of Fifty Million Pesos (PHP50,000,000.00). Thereafter, PACIFIC STAR sought to increase its authorized capital stock to One Hundred Fifty Million Pesos (PHP 150,000,000.00) with **the subscription thereto to be paid by way of the assignment of eighteen (18) parcels of land.** On July 27, 2004, the Securities and Exchange Commission **approved the application** and issued a Certificate of Approval of Increase of Authorized Capital Stock.[10] (Emphasis supplied)

As correctly argued by the CRMD, insufficient or partial consideration leads to watered stock which is prohibited by law. The subscription contract, described by PACIFIC STAR as "property-for-stock," is only 1 indivisible obligation to transfer 18 lots in exchange for an additional PHP 100 Million equity. That is what PACIFIC STAR applied for, and that is what CRMD approved. It follows that non-fulfillment of the transfer of all 18 lots would result in revocation.

Similarly, PACIFIC STAR's 2017 Manifestation, where it offered to substitute cash for the remaining land title, does not affect the CRMD's revocation. The CRMD revoked the approval of **18 lots as consideration**, because there were only 17 lots. The approval pertains to the terms of the subscription contract presented to CRMD, and since PACIFIC STAR did not apply for approval of "18 lots or cash," it cannot now change terms.

Section 63 of the Revised Corporation Code provides that only the full amount of the subscription is acceptable as consideration for shares, viz.

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[9] Increased ACS of PHP 150M minus Initial ACS of PHP 50M
[10] Page 2 of Memorandum on Appeal

> No certificate of stock shall be issued to a subscriber until the **full amount of his subscription** together with interest and expenses (in case of delinquent shares), if any is due, has been paid.

The principle expressed here is that a subscription contract is indivisible and incapable of partial fulfillment, which also means that it is not susceptible to substantial compliance. Applying this to the facts, **only 18 transferred lots—no more, no less—can warrant the Approval of Increase in Authorized Capital Stock.**

Meanwhile, **Section 61 of the Revised Corporation Code** adds that only "property xxx actually received by the corporation" is acceptable as consideration for shares. In this case, only 17 out 18 were actually received, and there is obviously **insufficient consideration** for the shares subject of the subscription contract.

Section 61 also states that "Stocks shall not be issued for a consideration less than the par or issued price thereof." While par is the minimum price for a share, **the issued price refers to the actual price of the subscription.** In this case, the issued price was exactly 18 lots in exchange for an additional PHP 100 Million equity. Thus, 17 lots cannot be accepted by the CRMD as substantial compliance, since it will result in **watered stock,**[11] *i.e.* an issuance for **less than the issued price of 18 lots**.

The second requirement, Due Process, was also satisfied. The CRMD gave PACIFIC STAR ample opportunity to be heard. **PACIFIC STAR duly-received the first Show Cause Order dated 11 August 2005**.

In response, **PACIFIC STAR appeared before the CRMD on 21 September 2005**, where it raised the substantial compliance argument reiterated in this appeal.

After the conference, the CRMD gave PACIFIC STAR a chance to submit a Report on the cause of the delay, which it failed to submit to CRMD.

The CRMD then attempted to serve a second Show Cause Order at the last known address of PACIFIC STAR, where previous orders were served, but the latter had apparently moved out on 20 February 2009. This second order merely reiterated the first, and did not raise any legal issues that PACIFIC STAR had not yet addressed at the conference.

Since PACIFIC STAR was unable to submit a timely Proof of Transfer, and since CRMD afforded ample opportunity to be heard, the Revocation complies with the SEC Guidelines Covering the Use of Properties Requiring Ownership Registration as Paid-up Capital. The CRMD also prevented partial payment of subscription and issuance of watered stock.

Therefore, the CRMD did not err in Revoking the Certificate of Approval of Increase of Authorized Capital Stock.

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[11] "Watered stock" is defined in **Section 64 of the Revised Corporation Code** as "the issuance of stocks for a consideration less than its par or issued value xxx"

NOT PRECLUDED FROM FILING FOR SUBSTITUTION OF PAYMENT

Notwithstanding the correctness of the CRMD ruling back in 2010, the stance of the Commission has changed with regard to the substitution of another consideration, such as cash, if the applicant is prevented for some meritorious reason from transferring title within the prescribed period.

SEC Memorandum Circular No. 14, Series of 2013 added the following provision to the SEC Guidelines Covering the Use of Properties Requiring Ownership Registration as Paid-up Capital, viz.

> In the event of inability to comply with the aforesaid condition [*i.e.* filing of proof of transfer within the prescribed period], the applicant corporation is not precluded from filing a verified petition for substitution of payment xxx

Thus, under the current SEC Guidelines, PACIFIC STAR is not precluded from filing a verified petition with the CRMD to be allowed to increase its authorized capital stock by substituting cash for the 18th land title which could not be transferred.

This shift in the Commission's policy, coupled with PACIFIC STAR's manifest intention to fulfill its obligation in cash, dictates that the operating department should consider the matter further.

WHEREFORE, the matter is hereby **REMANDED** to the CRMD for further proceedings.

PACIFIC STAR is directed to file a verified petition for substitute payment in cash, in lieu of real property, **within ten (10) days** from receipt of this Decision. Failure to comply within the period specified shall **automatically result** in the CRMD's Letter-Orders dated 23 July 2010 and 25 August 2010 being affirmed.

SO ORDERED.

Pasay City, Philippines; 7 March 2019.

EMILIO B. AQUINO
Chairperson

ANTONIETA F. IBE
Commissioner

EPHYRO LUIS B. AMATONG *
Commissioner

JAVEY PAUL D. FRANCISCO
Commissioner

KELVIN LESTER K. LEE
Commissioner

*Sick Leave