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

OFFICE OF THE GENERAL COUNSEL

07 September 2006

SEC-OGC Opinion No. 06-35
Preferred shares; Rate of dividends; Redemption

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Madam:

This refers to your letter dated 05 July 2006 seeking confirmation if the following items may be incorporated in the articles of incorporation and by-laws of Generali Pilipinas Holding Company Inc., Generali Pilipinas Life Insurance Company Inc. and Generali Pilipinas Insurance Company Inc. (collectively referred to herein as the "Generali") and in the Terms and Conditions of the redeemable preferred shares that will be issued by Generali:

> "1. exclusion of a dividend rate;
> 2. exclusion of a provision requiring upon redemption, the replacement of an equivalent amount of the newly paid-in shares so that the total paid-in capital stock is maintained at the same level immediately prior to redemption."

In general, the preferences and restrictions of any class of preferred shares are fixed in the charter or articles of incorporation.[1] This is stated in Section 6 of the Corporation Code, which reads in part as follows:

> "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 preferred shares of stock may be

[1] Ballantine on Corporations, §201, p. 471 (1927).

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> 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."

Based on the afore-quoted provision of the Corporation Code, the terms and conditions for the issuance of preferred shares may be stated in the articles of incorporation or the same may be fixed by the board of directors provided they are authorized under the articles of incorporation to fix the said terms and conditions. In addition, the terms and conditions must not be violative of the provisions of the Corporation Code.

With regard to the first proposed condition of the preferred shares, the exclusion of dividend rate for the preferred shares is not violative of any provision of the Corporation Code; hence, the same may be stated in the articles of incorporation, by-laws and Terms and Conditions of the preferred shares.

The following discussion is likewise instructive. Dividends are payable only when there are profits earned by the corporation and as a general rule, even if there are existing profits, the board of directors has the discretion to determine whether or not dividends are to be declared.[2] In the same vein, the directors may be authorized to vary the dividend rate of preferred shares on the condition that the board of directors are authorized under the articles of incorporation to fix the dividend rate.[3]

In spite of the specific preferences granted to preferred shares, there is no guaranty that the share will receive any dividends.[4] Thus, the dividend rate for the preferred shares may be decided by the board of directors of the corporation.

Relative to the second proposed term of the preferred shares, the same may not be allowed to be included in the articles of incorporation, by-laws and Terms and Conditions of the preferred shares of stock. To allow the same would defeat the purpose of Circular Letter No. 24-2005 dated 02 September 2005,[5] which is to cover up margin of solvency and capital impairment. Generali may, however, state in the Terms and Conditions that the preferred shares are non-retirable, which means that the same can be reissued at the same or higher price than the original price. The reissuance must be done immediately after redemption to maintain the same level of the total paid-in capital stock of Generali.

It must be noted that redemption by the corporation of its stock is, in a sense, a repurchase of it for cancellation. While redeemable shares may be redeemed regardless of the existence of unrestricted retained earnings, this is subject to the

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[2] Republic Planters Bank vs. Agana, Sr. et al. G.R. No. 51765, 03 March 1997.
[3] Ballantine, §201, p. 471.
[4] Villanueva. PHILIPPINE CORPORATE LAW, p. 543.
[5] The Circular Letter was issued by the Insurance Commission.

condition that the corporation has, after such redemption, assets in its books to cover debts and liabilities inclusive of capital stock.[6]

In view of the foregoing, this Office is of the opinion that Generali may amend its articles of incorporation and its by-laws to state therein that it would be converting the additional capital into equity shares, preferred shares in particular, to comply with the directive of the Insurance Commission. In the event, however, that the preferred shares are redeemed, Generali must replace or reissue the same immediately to maintain the same level of its paid-in capital stock before the redemption.

Very truly yours,

VERNETTE G. UMALI-PACO
General Counsel

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[6] Republic, supra.