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

31 March 2008
SEC-OGC Opinion No. 08-08
Transfer of Shares; Waiver of Pre-emptive Right; Election of Board of Directors

MR. HAZIEL MARK Z. AGUAYO
Kidapawan Doctors Hospital
Kidapawan City
Cotabato

Sir:

This pertains to your letter filed with this Commission on March 3, 2008 requesting opinion on the propriety of events and procedures in the conduct of business of the Kidapawan Doctors Hospital, Inc.

You alleged that:

1. There were sales made between individual stockholders without the knowledge of the rest of the stockholders.

2. Two documents were submitted to the SEC namely: a letter signed by the corporate secretary announcing the issuance of 52, 114 shares from the unissued capital stock and a notarized Secretary's Certification stating that during a special stockholders' meeting on September 30, 2006, stockholders were notified or informed of the call made by the Board for additional subscription.

3. Some stockholders made payments in excess of their pre-emptive rights. There was a discussion on whether to execute corresponding waivers of pre-emptive rights to the 52, 1104 shares in favor of stockholders who invested in excess of their pre-emptive rights or honor the pre-emptive rights and treat the excess payments as deposits.

4. During an election, a certain Melena Cabriles announced that she represented more than 70 percent of the votes and enumerated 7 nominees. The nomination was moved and seconded. The presiding officer asked if there was any objection and nobody commented. One

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of the nominees chose to decline her nomination and nominated Mr. Haziel Mark Z. Aguayo which was refused by the presiding officer. There was a request that the nominations be reopened and it was denied.

In your letter, you are requesting for an opinion on the following:

1. In the presence of specific provisions in the corporation's by-laws requiring that transfer/sale of shares of stock by stockholders follow a certain protocol, could transactions not complying with such procedures like private, direct transactions from one stockholder to another without the knowledge of the rest of the stockholders be consummated?

2. Does the waiver of pre-emptive rights by votes representing more than 2/3 of the outstanding capital stock in favor of a stockholder who has invested in excess of pre-emptive rights bind the remaining less than 1/3 who did not wish to waive their pre-emptive rights?

3. Was the conduct of elections in accordance with established /accepted rules in electing officers? Can a 70% majority control an election disregarding the right of the minority to nominate their candidate even before the actual voting begins?

Anent your **first query**, please be advised that the by-laws may prescribe the procedure regarding transfer of shares of stock. In the absence of the corporation's by-laws governing effective transfer of shares of stock, the pertinent provisions in the Corporation Code[1] apply. In your corporation's by-laws, Section 3 provides:

> *"Section 3. Transfer of Shares – **Subject to the restrictions, terms and conditions contained in the Articles of Incorporation**, shares may be transferred , sold, ceded, assigned or pledged by delivery of certificates duly indorsed by the stockholder, his attorney-in-fact, or other legally authorized person. The transfer shall be valid and binding on the corporation only upon record thereof in the books of the corporation, cancellation of the certificate surrendered to the Secretary, and issuance of a new certificate to the transferee. x x x" (Emphasis added)*

The corporation's by-laws prescribe that in order to have an effective transfer of shares of stock, there must be delivery of the duly indorsed certificate. The transfer is valid, except as between the parties, only until it is properly recorded in the books. As long as these requirements are met, the transfer of shares is effective and valid. But, it is important to note that the above-mentioned section in the by-laws is subject to the restrictions, terms and conditions in the Articles

1 *Section 63. Certificate of stock and transfer of shares.-- x x x 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.*
No shares of stock against which the corporation holds any unpaid claim shall be transferable in the books of the corporation.

of Incorporation.

Your Articles of Incorporation explicitly provide:

> *"Tenth:*
> *x x x*
> *The subscriptions for and the ownership of all shares of stock in the corporation are made and taken upon the condition that* ***any holder of shares of stock desiring to sell the same shall first offer in writing his stock to the corporation*** *at a fair value to be determined by the Board of Directors but which in no case shall be lower than the par value of each share, and the corporation shall have fifteen (15) days, counted from receipt by the secretary of the corporation of the written offer to sell, within which to exercise its option to purchase the same. Said offer to sell to the corporation shall be in writing and addressed to the secretary of the corporation.*
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> *"****On the corporation's failure to exercise its option*** *within said fifteen (15) days,* ***the holder of the shares of stock desiring to sell the same shall again offer in writing his stock to the stockholders*** *of the corporation at a fair value to be determined by the Board of Directors but which in no case shall be lower than the par value of each share, and the stockholders of the corporation shall have fifteen (15) days, counted from receipt by the secretary of the corporation of the said written offer to sell, within which to exercise their option to purchase the same. Said offer to sell to the stockholders of the corporation shall be in writing and addressed to the secretary of the corporation.*
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> *"****After the failure of the stockholders of the corporation to exercise their options*** *within the prescribed period,* ***the stockholder desiring to sell his shares shall be free to make any sale or transfer of his stock to any person****. This option in favor of the corporation and the stockholders shall appear in all types of Certificate of stock of the corporation.* ***Any transfer in violation of this provision shall be null and void.*** *x x x" (Emphasis added)*

Article 10 specifically provides for the procedure regarding transfer of shares. It is quite clear from the above provision that the intent is to give the corporation and the stockholders prior right over any other person to own the shares of stock of the corporation. It provides that transfers in violation of the provision shall be null and void. Hence, transfer of shares of stocks between stockholders are not valid unless the procedure prescribed in Article 10 is followed.

Anent your **second query**, please be advised that pre-emptive right is the right of a stockholder to subscribe to all new issues of shares of any class which result from the increase in capital stock in proportion to his shareholdings. The foundation or underlying basis of this right is to maintain the proportionate voting strength and control of existing stockholders that is the existing ratio of their interest and voting power in the corporation.[2] Being a personal right, such waiver should be executed individually by the stockholders concerned or he may authorize

2 SEC Opinion 09-30-1992 dated September 30, 1992 addressed to Industrial Security Consultancy and Management, Inc.

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somebody to execute the same for and in his behalf by way of a special power of attorney.[3] Hence, a stockholder cannot be forced to waive this right even if the majority of the stockholders opt to waive it. A stockholder can only be denied this right when it is provided for in the articles of incorporation or an amendment thereto[4].

Anent your **third query**, please be advised that the manner and procedure to be followed in the election of officers and members of the board of directors of a corporation are usually embodied in the by-laws and this procedure shall govern the members in all their election proceedings, provided that the same is not contrary to the provisions of the Corporation Code.[5]

In the absence in the by-laws of procedure governing election of board of directors, the pertinent provision of the Corporation Code will apply. The Code provides for the voting procedure in the election of directors:

> *"Section 24. Election of directors or trustees.-- At all elections of directors or trustees, there must be present, either in person or by representative authorized to act by written proxy, the owners of the majority of the outstanding capital stock, or if there be no capital stock, a majority of the members entitled to vote. The election must be by ballot if requested by any voting stockholder or member. In stock corporations, every stockholder entitled to vote shall have the right to vote in person or by proxy the number of shares of stock standing, at the time fixed in the by-laws, in his own name on the stock books of the corporation, or where the by-laws are silent, at the time of the election; and said stockholder may vote such number of shares for as many persons as there are directors to be elected or he may cumulate said shares and give one candidate as many votes as the number of directors to be elected multiplied by the number of his shares shall equal, or he may distribute them on the same principle among as many candidates as he shall see fit: Provided, That the total number of votes cast by him shall not exceed the number of shares owned by him as shown in the books of the corporation multiplied by the whole number of directors to be elected; Provided, however, That no delinquent stock shall be voted. Unless otherwise provided in the articles of incorporation or in the by-laws, members of corporations which have no capital stock may cast as many votes as there are trustees to be elected but may not cast more than one vote for one candidate.* ***Candidates receiving the highest number of votes shall be declared elected.*** *x x x (Emphasis added)*

To question the legality of the election, the proper remedy is to file a complaint with the

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3 SEC Opinion 10-01-1981 dated October 1, 1981 addressed to Mr. Fernando C. Santico; SEC Opinion 12-06-1994 dated December 6, 1994 addressed to Atty. Marcial O.T. Balgos

4 *Section 39. Power to deny pre-emptive right.--All stockholders of a stock corporation shall enjoy pre-emptive right to subscribe to all issues or disposition of shares of any class, in proportion to their respective shareholdings, unless such right is denied by the articles of incorporation or an amendment thereto: Provided, That such pre-emptive right shall not extend to shares to be issued in compliance with laws requiring stock offerings or minimum stock ownership by the public; or to shares to be issued in good faith with the approval of the stockholders representing two-thirds (2/3) of the outstanding capital stock, in exchange for property needed for corporate purposes or in payment of a previously contracted debt.*

5 SEC Opinion dated March 18, 1981addressed to Ison, Medel and Liwag; SEC Opinion 06-23 dated April 5, 2006 addressed to Mr. Marcelino T. Delson

proper Regional Trial Court. Cases involving controversies in election of directors fall under the jurisdiction of the Regular Courts.[6] Thus, the Commission shall refrain from rendering opinion regarding the legality or illegality of the election. Moreover, the Commission cannot render an opinion on matters which involve the substantive and contractual rights of private parties who would, in all probability, contest the same in court if the opinion turns out to be adverse to their interest.[7]

Finally, please be reminded that the foregoing opinion is based solely on the facts and circumstances disclosed in your request and relevant only to the particular issue raised therein and shall not be used in the nature of a standing rule binding upon the Commission in other cases whether similar or dissimilar circumstances. If upon investigation, it will be disclosed that the facts relied upon are different, this opinion shall be rendered null and void.

For your information and guidance.

VERNETTE G. UMALI-PACO
General Counsel

6 Rule 1 Section 1 (a) 1, A.M. No. 01-2-04-SC Re: Proposed Interim Rules of Procedure Governing Intra-corporate Controversies Under R.A. No. 8799

7 SEC Memorandum Circular No. 15, series of 2003

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