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

OFFICE OF THE GENERAL COUNSEL

31 March 2010

SEC-OGC Opinion No. 10-14
Re: Acquisition of Own
Shares of Stock

SEBASTIAN LIGANOR GALINATO & ALAMIS
1409 East Tower, PSE Center,
Exchange Road, Ortigas Center, Pasig City

ATTENTION: Atty. Jon Michael Alamis &
Atty. Sheryl L. Olaño

Gentlemen:

This refers to your letter dated 01 December 2009 requesting confirmation that the acquisition by the Orchard Golf & Country Club, Inc. (the Club) of its own shares of stock is exempt from the requirement of Section 41 of the Corporation Code in relation to unrestricted retained earnings.

As disclosed in your letter, the Club has an authorized capital stock of 3,000 no par value shares. Majority of these shares have already been subscribed by and sold to individual shareholders. However, some shareholders of the Club have mortgaged and/or pledged their respective shares to third parties who can foreclose the same in the event that the said shareholders default on their loans.

In case of foreclosure, the Club's By-Laws provide that the Club has the right to repurchase the foreclosed share from the winning bidder.

Meanwhile, some shareholders have likewise been delinquent in the payment of monthly dues to the Club. The Club's By-Laws also provide that, in case of delinquency in the payment of the said monthly dues, the Club may order the public auction sale of the shares pertaining to the delinquent shareholder.

It is your position that the Club may acquire its own shares by purchasing the same from the winning bidder in the foreclosure sale or by purchasing the shares sold at the public auction for non-payment of monthly dues even if the Club has no

unrestricted retained earnings.

Relevant to your query is the provision of the Corporation Code (the Code) on the acquisition of one's own shares, which reads:

> *"**Sec. 41. Power to acquire own shares.** — A stock corporation shall have the power to purchase or acquire its own shares for a legitimate corporate purpose or purposes, including but not limited to the following cases: **Provided, That the corporation has unrestricted retained earnings in its books to cover the shares to be purchased or acquired:***
>
> *1. To eliminate fractional shares arising out of stock dividends;*
>
> *2. To collect or compromise an indebtedness to the corporation, arising out of unpaid subscription, in a delinquency sale, and to purchase delinquent shares sold during said sale; and*
>
> *3. To pay dissenting or withdrawing stockholders entitled to payment for their shares under the provisions of this Code. (a)"* (emphasis supplied)

The Rules Governing Redeemable and Treasury Shares[1] are likewise instructive on this point, which provide:

> ***Section 1. General Provisions. — The outstanding capital stock of a corporation**, including unpaid subscriptions, **shall constitute a trust fund held by the corporation for the benefit of its creditors which shall not be returned to the stockholders by repurchase of shares** or otherwise, except in the manner as provided for under the Corporation Code and these rules.*
>
> *xxx xxx xxx*
>
> ***SECTION 3. Redeemable Treasury Shares. —***
>
> *1. **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**, xxx"* (emphasis supplied)
>
> *xxx xxx xxx*

From the foregoing, a corporation is only authorized to purchase or acquire its own shares if the said acquisition has legitimate corporate purpose/purposes and only if the corporation has unrestricted retained earnings.[2]

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[1] Corporation Code of the Philippines (CCP) No. 1 (1982).

[2] SEC Opinions dated 27 March 1995 (to Atty. Marietta Turingan), 12 October 1992 (to Mr. Lauris L. dela Peña), 11 September 1985 (to Tierra International Construction Corporation) and 15 December 1982 (to Trident Development Corporation) elaborated further that a corporation may re-acquire or purchase its own stock under the following conditions:

a.) Its capital is not thereby impaired;

b.) A legitimate and proper corporate objective is advanced;

You advanced the position that the Club's acquisition of its own shares will be made in good faith considering that it is the only way the Club can protect the price of its shares and consequently its image and prestige.

The aforesaid position, assuming that it qualifies as a legitimate corporate purpose, merely answers the first requirement in the acquisition of the Club's own shares. It does not respond to the second requirement which is the presence of unrestricted retained earnings to support the cost of the said acquisition.

Nevertheless, you advanced another position that the Club can never have unrestricted retained earnings since it is a non-profit organization. As such, the Club operates mainly to provide its stockholders with facilities for outdoor sports activities. Moreover, you alleged that said activities do not generate revenues for the Club considering that the monthly dues collected are actually used to defray costs for the maintenance and repair of the Club's facilities.

This Office is of the opinion, however, that while the operation of the Club does not generate profit, such non-profitable operation does not necessarily make the Club as a non-profit organization. Technically, a non-profit corporation is defined as a corporation where no part of its income is distributable to its members, directors or officers and is prohibited from having or issuing shares of stock and paying dividends.[3] In other words, it is a corporation whose by-laws prohibit the use of its profits or surplus as dividends.[4]

As alleged in your letter, the Club is a stock corporation with authorized capital stock of 3,000 no par value shares. Being a stock corporation, its capital stock is divided into shares and is authorized to distribute to holders thereof such dividends or allotments of the surplus profits on the basis of the shares held.[5] Although the operation of the Club does not generate unrestricted retained earnings at the moment, it still has the capacity to generate and authority to distribute the same to its stockholders. Thus, the Club, being a stock corporation, must first have unrestricted retained earnings before it can acquire its own shares.

The underlying reason for limiting the said share purchases springs from the necessity of imposing safeguards against the depletion by a corporation of its assets and the impairment of its capital needed for the protection of its creditors.[6] It is perceived that as long as the acquisition of shares does not exceed the unrestricted

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c.) The condition of corporate affairs warrants it:
d.) The transaction is designed and carried out in good faith;
e.) There is intended and there results no undue advantage to a few favored stockholders at the expense of the remainder;
f.) The rights of creditors are not jeopardized.
g.) There must be unrestricted retained earnings to acquire the same.

[3] §68, 1 FLETCHER CYCLOPEDIA CORPORATIONS 328 (Permanent Ed.).
[4] *See* Debs Memorial Radio Fund v. C.I.R, 2 Cir., 148 F.2d 948.
[5] Sec. 3, Coroporation Code of the Philippines.
[6] *See* Ballantine, Law of Corporation (Rev. Ed.), p. 605, citing legal periodicals.

retained earnings, the corporate creditors are deemed protected.[7]

Moreover, based on the Club's "2008 audited financial statements (AFS), it has a '***Cumulative excess of expenses over members' contribution fees***' amounting to P317.89 Million. This means that the company has accumulated losses, which renders it financially incapable of acquiring its own shares of stock pursuant to the provisions of Section 41 of the Code."[8]

In view of the foregoing, we could not confirm that the acquisition by the Club of its own shares of stock is exempt from the requirement of Section 41 of the Corporation Code in relation to unrestricted retained earnings.

It shall be understood that the foregoing opinion is rendered based solely on the facts and circumstances disclosed and relevant solely to the particular issues raised therein and shall not be used in the nature of a standing rule binding upon the Commission in other cases whether of similar or dissimilar circumstances.[9] If, upon further inquiry, it will be disclosed that the facts relied upon are different, this opinion shall be rendered null and void.

Please be guided accordingly.

Very truly yours,

VERNETTE G. UMALI-PACO
General Counsel

[7] CESAR L. VILLANUEVA, PHILIPPINE CORPORATE LAW 580 (2001 ed.).
[8] Memorandum dated 26 February 2010 from the Office of the General Accountant to the Office of the General Counsel.
[9] SEC Memorandum Circular No. 15-03, 16 December 2003.