Republic of the Philippines
SECURITIES AND EXCHANGE COMMISSION
SEC Bldg. EDSA, Greenhills, Mandaluyong City

OFFICE OF THE GENERAL COUNSEL

23 April 2010

SEC-OGC Opinion No. 10-15
Delinquent Stocks, Delinquency Sale, Effect of Delinquency

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Sir:

This refers to your query regarding delinquent stockholders. In your letter dated 24 February 2009, you narrated that Medicus Philippine Paramedical & Technical School (Iloilo), Inc. ("Medicus") made a call for payment for unpaid subscriptions and declared a major subscription as delinquent[1] as of November 15, 2008. The subscription amounts to 59.99% of the total stocks, of which 46.12% remains unpaid. A public auction was held on 15 January 2009, which ended up in failure. As a result, you requested clarification on the following:

1) a. What is the effect of delinquency on the voting rights of the stockholder? Does it affect only the unpaid shares or the whole subscription of the delinquent stockholder?

   b. Assuming that the delinquency affects the whole subscription of the delinquent stockholder, are the stockholders of the remaining paid up subscriptions (40.01% of the total stocks), not delinquent, the only ones entitled to vote during the stockholders' meeting?

[1] Delinquent subscription refers to subscription that have been declared by the board of directors as such after the subscriber failed to settle the same after a period of 30 days from the date the subscription became due as specified in the contract of subscription or in the call made by the board of directors. (SEC Memorandum Circular No. 11, Series of 2008.)

2) Is there a limit to the number of times that unpaid subscriptions may be auctioned?

3) In the event that the auction is successful, should the certificate of stocks cover only the unpaid portion of the subscription? If so, what is the effect on the paid shares of the delinquent stockholder?

4) Can Medicus sell portions of the delinquent shares ("in small pieces") even while they are not treasury shares inasmuch as the corporation cannot buy all the remaining shares of the delinquent stockholder?

Query No. 1

A) The effect of delinquency on the voting rights of the stockholder is found in Section 71 of the Corporation Code ("Code") which provides that "No delinquent stock shall be voted for or be entitled to vote or to representation at any stockholder's meeting xxx." Section 24 of the Code on election of directors also provides, "xxx no delinquent stock shall be voted." In this case, since Medicus made a call for payment for unpaid subscriptions and declared subject subscription as delinquent as of November 15, 2008, Section 71 applies. Said delinquent stocks cannot be voted for or be entitled to vote at any stockholders' meeting.

On the question of whether this affects only the unpaid shares or the whole subscription of the delinquent stockholder, the answer is in Section 64 of the same Code which provides that "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." This implicitly sets forth the doctrine that a subscription contract is one, entire and indivisible contract. It cannot be divided into portions so that the stockholder shall not be entitled to a certificate of stock until full payment of his subscription together with interest, and expenses if any is due.[2] Therefore, the entire delinquent subscription cannot be voted for or be entitled to vote.[3] In addition, Section 67 of the Code provides:

> "xxx Payment of any unpaid subscription or any percentage thereof, together with the interest accrued, if any, shall be made on the date specified in the contract of subscription or on the date stated in the call made by the board. ***Failure to pay on such date shall render the entire balance due and payable*** and shall make the stockholder liable

[2] SEC Opinion dated April 11,1994 addressed to Mr. Gonzales M. Mallari.
[3] SEC Opinion dated March 13, 1998 addressed to Atty. Jose A. Feria.

> for interest at the legal rate on such balance, unless a different rate of interest is provided in the by-laws, computed from such date until full payment. If within thirty (30) days from the said date no payment is made, ***all stocks covered by said subscription shall thereupon become delinquent*** and shall be subject to sale as hereinafter provided, unless the board of directors orders otherwise." (emphasis supplied)

B) Because Medicus' major stockholder (59.99% of the total stocks) has been declared delinquent, only 40.01% of the total stocks, fully paid and not delinquent, are the only stocks entitled to vote during the stockholders' meeting, based on Section 71[4] of the Code. Even if the subscriptions are not fully paid, as long as they are not delinquent, the stockholders thereof are entitled to vote, based on Section 72[5] of the Code.

However, Section 52 of the Code provides that "Unless otherwise provided for in this Code or in the by-laws, a quorum[6] shall consist of the stockholders representing a majority of the outstanding capital stock[7] xxx." Article II Section 5 of the by- laws of Medicus provides:

> "Unless otherwise provided by law, in all regular or special meetings of stockholders, ***a majority of the outstanding capital stock must be present or represented in order to constitute a quorum***. If no quorum is constituted, the meeting shall be adjourned until the requisite amount of stock shall be present." (emphasis supplied)

Therefore, it appears that even if 40.01% of the total stocks, fully paid and not delinquent, are entitled to vote, Medicus cannot muster a quorum unless the 59.99% of the total stocks are sold.

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[4] Section 71. Effect of delinquency. — No delinquent stock shall be voted for or be entitled to vote or to representation at any stockholder's meeting, nor shall the holder thereof be entitled to any of the rights of a stockholder except the right to dividends in accordance with the provisions of this Code, until and unless he pays the amount due on his subscription with accrued interest, and the costs and expenses of advertisement, if any.

[5] Section 72. Rights of unpaid shares.-Holders of subscribed shares not fully paid which are not delinquent shall have all the rights of a stockholder.

[6] Section 52.Quorum in meetings. — Unless otherwise provided for in this Code or in the by-laws, a quorum shall consist of the stockholders representing a majority of the outstanding capital stock or a majority of the members in the case of non-stock corporations.

[7] Section 137.Outstanding capital stock defined. — The term "outstanding capital stock", as used in this Code, means the total shares of stock issued under binding subscription agreements to subscribers or stockholders, whether or not fully or partially paid, except treasury shares.

Query No. 2

Section 68[8] of the Code provides for the sale in a public auction of delinquent shares. Nothing therein provides any limit to the number of times that unpaid subscriptions may be auctioned. It may benefit Medicus to know that the Code allows two remedies for the enforcement of liability for unpaid subscriptions: 1) to put up delinquent unpaid subscription for sale under Section 68; and 2) to file an action in court under Section 70.[9]

Query No. 3

In the event that the auction is successful,[10] the corporation must issue a certificate of stock covering the entire subscription [11] and not for "only the unpaid

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[8] Section 68. Delinquency sale. — The board of directors may, by resolution, order the sale of delinquent stock and shall specifically state the amount due on each subscription plus all accrued interest, and the date, time and place of the sale which shall not be less than thirty (30) days nor more than sixty (60) days from the date the stocks become delinquent.
Notice of said sale, with a copy of the resolution, shall be sent to every delinquent stockholder either personally or by registered mail. The same shall furthermore be published once a week for two (2) consecutive weeks in a newspaper of general circulation in the province or city where the principal office of the corporation is located.
Unless the delinquent stockholder pays to the corporation, on or before the date specified for the sale of the delinquent stock, the balance due on his subscription, plus accrued interest, costs of advertisement and expenses of sale, or unless the board of directors otherwise orders, **said delinquent stock shall be sold at public auction** to such bidder who shall offer to pay the full amount of the balance on the subscription together with accrued interest, costs of advertisement and expenses of sale, for the smallest number of shares or fraction of a share. The stock so purchased shall be transferred to such purchaser in the books of the corporation and a certificate for such stock shall be issued in his favor. The remaining shares, if any, shall be credited in favor of the delinquent stockholder who shall likewise be entitled to the issuance of a certificate of stock covering such shares.
Should there be no bidder at the public auction who offers to pay the full amount of the balance on the subscription together with accrued interest, costs of advertisement and expenses of sale, for the smallest number of shares or fraction of a share, the corporation may, subject to the provisions of this Code, bid for the same, and the total amount due shall be credited as paid in full in the books of the corporation.
Title to all the shares of stock covered by the subscription shall be vested in the corporation as treasury shares and may be disposed of by said corporation in accordance with the provisions of this Code.

[9] SEC Opinion dated September 30, 1991 addressed to Fernando C. Santico citing Velasco vs. Poisat, 37 Phil. 802.

[10] In compliance with the requirements of Sec. 68 of the CC "...said delinquent stock shall be sold at public auction to such bidder who shall offer to pay the full amount of the balance on the subscription together with accrued interest, costs of advertisement and expenses of sale, for the smallest number of shares or fraction of a share. ..."

[11] "Sec. 68, CC: xxx The stock so purchased shall be transferred to such purchaser in the books of the corporation and a certificate for such stock shall be issued in his favor. xxx."

portion of the subscription." This is consistent with this Commission's opinions interpreting Section 64 of the Code,[12] which applies to this particular query.

Before the effectivity of Section 64 of the Code, [13] Section 37 of the Corporation Law[14] was interpreted by the Supreme Court in *Baltazar & Lingayen Gulf Electric Power Co., Inc.* (L-16236-38, June 30, 1965) ruling that, a corporation may, in the absence of provisions in the by-laws to the contrary, apply payments made by the subscribers-stockholders, either as: a) full payment for the corresponding number of stocks the par value of which is covered by such payment, or b) as proportionate payment of each and all entire number of subscribed shares. If the corporation has chosen one option it cannot change to the other without the unanimous consent of the stockholders. However, as early as September 1, 1982, after the effectivity of the Code[15] thi s Commission rendered an opinion that Section 64 "renders the ruling in the Lingayen Gulf case obsolete. Considering that this rule is mandatory, by-laws provisions following said ruling are therefore rendered of no effect." [16]

The principle of indivisibility of subscription is absolute as Section 64 of the Code speaks of no exception.[17] Thus, partial payment to a subscription contract shall be deemed forfeited and the whole subscription shall be declared delinquent upon failure of the stockholder to pay the balance on the date fixed by the board on call of subscription.[18]

Query No. 4

Again, because of the principle of the indivisibility of subscription under Section 64 of the Code, the subscription cannot be divided into portions.[19] In one instance, the Commission opined that:

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[12] SEC Opinion dated September 1, 1982, Feria, Feria, Lugtu and Lao; SEC Opinion dated January 6, 1983, Bay Sunset Tours & Travel Corp.; SEC Opinion dated April 27, 1990, Romulo, Mabanta Buenaventura, Sayoc and de los Reyes; SEC Opinion September 17, 1990, Atty. Luciano S. Borja, SEC Opinion dated June 6, 1991, Atty. Damaso P. Uy; SEC Opinion June 3, 1994, Ms. Concepcion C. Madarang; SEC Opinion October 9, 1995, Atty. A.B.F. Gaviola, Jr.

[13] Approved and effective on May 1, 1980.

[14] "Sec. 37. xxx No certificate of stock shall be issued to a subscriber as fully paid until the full par value thereof, or the full subscription in the case of no par stock, has been paid by him to the corporation. Subscribed shares not fully paid up may be voted provided no subscription call or interest due on subscription is unpaid and delinquent."

[15] SEC Opinion dated September 1, 1982, Feria, Feria, Lugtu and Lao.

[16] Citing Balbin & Gloria, The Corporate Organization: New Dimensions 77 (1981).

[17] SEC Opinion dated September 3, 1982, Mr. Adolfo Martinez.

[18] SEC Opinion dated June 21, 1989 addressed to Atty. Vicente M. Aujero; SEC Opinion dated August 20, 2001 addressed to MR. Dante B. Adeva.

[19] SEC letter dated January 6, 1983 addressed to Bay Sunset Tours & Travel Corporation.

> "Accordingly, if the stockholder has not paid the full amount of his subscription, he ***cannot transfer part of it in view of the indivisible nature of subscription contract***. It is only upon full payment of the whole subscription that a stockholder can transfer the same to several transferees. However, the entire subscription, although not yet fully paid, may be transferred to a single transferee, who as a result of the transfer, must assume the unpaid balance. It is necessary, however, to secure the consent of the corporation since the transfer of subscription right contemplates a novation of contract which under Article 1293 of the Civil Code of the Philippines, cannot be made without the consent of the creditor."[20]

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. If, upon investigation, 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

[20] SEC Opinion dated April 11, 1994 addressed to Mr. Gonzales M. Mallari.