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

12 April 2010

SEC-OGC Opinion No. 10-18
Capital Restructuring

Nolledo Hermosura & Uriarte-Tan
32nd Floor, Tower One & Exchange Plaza,
Ayala Triangle, Ayala Avenue, Makati City

Attention: **Mr. Solomon M. Hermosura**

Gentlemen:

This refers to your letter dated 24 November 2009 requesting confirmation that Crans Montana Properties Holding Corporation ("Crans") may partially return its capital to its sole stockholder, Ayala Land, Inc. ("ALI"), through a reduction of its capital stock in accordance with its proposed capital restructuring as described below:

I. Crans will amend its Articles of Incorporation such that the portion of its existing common capital stock, with a par value of ten pesos (P10.00) per share, shall be ***reclassified into redeemable preferred shares,*** with a par value of ten pesos (P10.00) per share;

II. At present, Cran's capital structure is as follows:

	Number of Shares	**Amount**
Authorized	12,000,000 Common	P120,000,000.00
Issued	11,751,838 Common	P580,357,918.00

III. With the consent of ALI, Crans will reclassify 7,954,648 of its issued common shares into redeemable preferred shares. After the proposed reclassification, Crans' capital structure will reflect as follows:

	Number of Shares	**Amount**
Authorized	12,000,000 Common	P120,000,000.00
Issued	3,797,190 Common	P187,522,095.07
	7,954,648 Redeemable Preferred	P392,835,822.93

IV. The redeemable preferred shares may be redeemed at the option of Crans at their issued value, which is P49.3844 per share. The shares cannot be reissued after redemption;

V. With the consent of ALI, Crans will pay the redemption amount for all the redeemable shares in kind, specifically a parcel of land in Malugay, Makati City, which ALI and Crans have agreed to have a value equal to the redemption period;

VI. After the redemption of the redeemable preferred shares, Crans will amend its Articles of Incorporation to decrease its capital stock through the elimination of its retired preferred redeemable shares. Thus, the resulting capital structure of Crans will be as follows:

	Number of Shares	Amount
Authorized	4,045,352 Common	P40,453,520.00
Issued	3,797,190 Common	P187,522,095.07

Validity of the Proposed Capital Restructuring

Under Section 6[1] of the Corporation Code,[2] stock corporations are authorized

[1] **Sec. 6.** ***Classification of shares.*** - The shares of stock of stock corporations may be divided into classes or series of shares, or both, any of which classes or series of shares may have such rights, privileges or restrictions as may be stated in the articles of incorporation: Provided, That no share may be deprived of voting rights except those classified and issued as "preferred" or "redeemable" shares, unless otherwise provided in this Code: Provided, further, That there shall always be a class or series of shares which have complete voting rights. Any or all of the shares or series of shares may have a par value or have no par value as may be provided for in the articles of incorporation: Provided, however, That banks, trust companies, insurance companies, public utilities, and building and loan associations shall not be permitted to issue no-par value shares of stock.

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 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.

Shares of capital stock issued without par value shall be deemed fully paid and non-assessable and the holder of such shares shall not be liable to the corporation or to its creditors in respect thereto: Provided; That shares without par value may not be issued for a consideration less than the value of five (P5.00) pesos per share: Provided, further, That the entire consideration received by the corporation for its no-par value shares shall be treated as capital and shall not be available for distribution as dividends.

A corporation may, furthermore, classify its shares for the purpose of insuring compliance with constitutional or legal requirements.

Except as otherwise provided in the articles of incorporation and stated in the certificate of stock, each share shall be equal in all respects to every other share.

Where the articles of incorporation provide for non-voting shares in the cases allowed by this Code, the holders of such shares shall nevertheless be entitled to vote on the following matters:

to divide shares into classes or series of shares, or both, any of which classes or series of shares may have such rights, privileges, or restrictions as may be stated in the articles of incorporation. The classes and number of shares which a corporation shall issue are first determined by the incorporators as stated in the articles of incorporation filed with the Commission. After the corporation comes into existence, they may be altered by the board of directors and the stockholders by amending the articles of incorporation.

In considering the conversion of Crans' 7,954,648 common shares to redeemable preferred shares, such conversion can only be effected if the shares have a "convertibility feature" expressly provided for in its articles of incorporation.[3] And although they may have a convertible feature in the articles of incorporation, their conversion is not automatic. An amendment of the articles of incorporation is required to formalize the conversion which must not result in the watering of stock or issuance of stock in excess of the authorized capital stock of the corporation.[4]

From the foregoing, it is mandatory that before a reclassification of Crans' shares be effected, it must be expressly stated in its articles of incorporation that the 7,954,648 common shares have a convertibility feature. The articles of incorporation is a contract between the state and the corporation, between the corporation and the stockholders, and between the stockholders and the state. Such being the case, any provision therein cannot be changed without the formalities required under existing laws.[5] However, Crans' articles of incorporation particularly paragraph seven thereof, does not expressly specify the option to convert the 7,954,648 common shares to redeemable preferred shares. Thus, Crans should first amend its articles of incorporation indicating the convertibility of the 7,954,648 common shares to redeemable preferred shares before a reclassification is made.

More so, before shares can be redeemed, the rights of the creditors must not

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1. Amendment of the articles of incorporation;

2. Adoption and amendment of by-laws;

3. Sale, lease, exchange, mortgage, pledge or other disposition of all or substantially all of the corporate property;

4. Incurring, creating or increasing bonded indebtedness;

5. Increase or decrease of capital stock;

6. Merger or consolidation of the corporation with another corporation or other corporations;

7. Investment of corporate funds in another corporation or business in accordance with this Code; and

8. Dissolution of the corporation.

Except as provided in the immediately preceding paragraph, the vote necessary to approve a particular corporate act as provided in this Code shall be deemed to refer only to stocks with voting rights.

[2] Batas Pambansa Blg. 68 (1980).
[3] SEC Opinion dated 19 May 1982 addressed to Mr. Leoncio Palanca.
[4] SEC Opinion dated 10 May 2002 addressed to Attys. Emmanuel Paras, Angel Salita, Jr., and Philbert Varona.
[5] SEC Opinion dated 03 August 1990 addressed to Atty. Ricardo N. Fernandez, Jr.

be prejudiced.[6] Under the Trust Fund Doctrine, which is an established doctrine in our jurisdiction, subscriptions to the capital of a corporation constitute a fund to which the creditors have a right to look for satisfaction of their claims.[7] The capital stock, property and assets of the corporation are regarded as equity in trust for the payment of corporate creditors.[8] Thus, the consent of the creditors must be secured first before the value of the decrease in the capital stock may be distributed to the stockholders.

With regard to the reduction in capital stock, Section 38 of the Corporation Code grants a corporation the power to increase or decrease its capital stock. Though it is a management prerogative, **strict compliance** with the procedures and requirements for decreasing (increasing) a capital stock is necessary, to wit:

1. Amendment of the pertinent provisions of the articles of incorporation indicating the amount of decrease if:

    a) Approved in a board meeting by the majority vote of the board of directors;

    b) Approved in a regular or special stockholders' meeting, after prior written notice to the stockholders served personally or by mail in accordance with its by-laws, indicating (i) the proposed decrease and (ii) the time and place of the stockholders' meeting, by 2/3 of the outstanding capital stock;

    c) The resolution approved by the required votes of directors and stockholders, which should be quoted in the certificate, should indicate the proportionate reduction in the number of shares each stockholder will receive in relation to the decreased capital stock and the deadline a stockholder shall surrender his certificate of stock in exchange for a new certificate indicating the reduced number of shares.

2. Evidenced by director's sworn certificate signed by majority of the directors and countersigned by the chairman and the secretary of the stockholders' meeting, to be submitted to the Commission.[9]

The formal procedures provided for in Section 38 clearly reveal that a decrease of the capital stock consequently amends the underlying contractual relationship between the corporation and its stockholders. For this reason, the consent of the contracting parties is required to give effect to such power of the corporation to decrease its capital stock.

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[6] SEC opinion dated 03 August 1990, addressed to Ricardo Fernandez, Jr..
[7] Philippine Trust Co. vs. Rivera, G.R. No. 19761, January 29, 1923.
[8] Commissioner of Internal Revenue vs. CA, 301 SCRA 152 (1999).
[9] R.E. Agpalo, COMMENTS ON THE CORPORATION CODE OF THE PHILIPPINES, 201-202 (2001).

Based on the foregoing discussion, this Office thus opines that aside from the requirement that Crans amend its articles of incorporation to reflect the "convertibility clause" of the particular shares, it should likewise comply strictly with the formalities laid down in Section 38 of the Corporation Code.

The foregoing opinion rendered is based solely on the facts disclosed in the query 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. If upon investigation, it will be disclosed that the facts relied upon are different, this opinion shall be rendered null and void.

Very truly yours,

VERNETTE G. UMALI-PACO
General Counsel