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

OFFICE OF THE GENERAL COUNSEL

07 March 2011

SEC-OGC Opinion No. 11-09
Sale of stock in excess of authorized capital stock

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Sir:

This refers to the letter of your client dated 14 January 2011 and your follow-up letter dated 7 February 2011 that raised the following questions:

1. "Can a corporation issue a stock certificate beyond the total number of shares reflected in its articles of incorporation?
2. If not, what is the provision in the Corporation Codes has the entity had violated? [sic]
3. As a regulating body, how should SEC act in response to said situation?
4. In such a case, what legal action must be taken by the investors who were misled?
5. Does the SEC have the full mandate under existing laws to resolve the said issue?"

The facts as culled from your letter are as follows:

Daiwa CDM Plantation Corporation ("Daiwa", for brevity) with SEC Registration No. CS2010003252 was registered on 4 March 2010 with an authorized capital stock of one million pesos (P1,000,000.00) divided into ten thousand (10,000) shares at one hundred pesos (P100.00) per share.

You allege that Daiwa sold a total of twelve thousand six hundred fifty-five (12,655) shares to your friends and another five thousand sixty-five (5,065) shares to another corporation, in excess of the authorized shares.

You allege that a long time has already passed since Daiwa last communicated with its investors, and that it cannot be contacted or located at its given addresses. Thus, your query.

To answer your first and second questions, we are of the opinion that a corporation cannot issue stocks in excess of the authorized capital stock as reflected

in its articles of incorporation. We refer you to the Corporation Code[1], specifically to Title IV, Powers of Corporations on Section 36 that provides:

> "Sec. 36. ***Corporate powers and capacity.*** – Every corporation incorporated under this Code has the power and capacity:
>
> xxx
>
> 6. In case of stock corporations, to issue or sell stocks to subscribers and to sell treasury stocks in accordance with the provisions of this code; xxx
>
> xxx"

A corporation has the power to issue or sell its stocks. However, it is only allowed to issue or sell such stocks which are authorized – the number of these being stated in a corporation's articles of incorporation.

A corporation may increase its capital stock, subject to the approval of the Commission.[2] A corporation must acquire this approval of the increase. This approval is embodied by the registration of the Commission of the corporation's amended articles of incorporation. Absent such authorized increase in capital stock, a corporation cannot issue or sell stocks in excess of the number of stocks in its original articles of incorporation.

Since shares of stock fall squarely under the definition of "securities[3]", the act of selling such unauthorized stocks is a violation of Section 8.1 of the Securities Regulation Code[4] ("SRC") that provides:

> "8.1. Securities shall not be sold or offered for sale or distribution within the Philippines, without a registration statement duly filed with and approved by the Commission. Prior to such sale, information on the

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[1] Batas Pambansa Blg. 68 (1980).

[2] Sec. 38. ***Power to increase or decrease capital stock; incur create or increase bonded indebtedness.*** – **xxx**

Any increase or decrease in the capital stock or the incurring, creating or increasing of any bonded indebtedness shall require prior approval of the Securities and Exchange Commission.

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[3] Securities Regulation Code. Section 3. ***Definition of Terms.*** – 3.1. *"Securities"* are shares, participation or interests in a corporation or in a commercial enterprise or profit-making venture and evidenced by a certificate, contract, instrument, whether written or electronic in character. It includes:

(a) Shares of stock, bonds, debentures, notes, evidence of indebtedness, asset-backed securities;

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[4] Republic Act No. 8799 (2000).

securities, in such form and with such substance as the Commission may prescribe, shall be made available to each prospective purchaser."

As to your third question, the Commission may conduct an investigation into the matter, and based on the results of such investigation, the Commission may impose sanctions for violation of the laws and rules.

Regarding your fourth question, investors who were allegedly misled by the corporation may approach the Enforcement and Prosecution Department ("EPD") of the SEC to initiate proceedings to investigate the matter, and should the EPD find cause to do so, it may commence a suit against the erring corporation on behalf of the investors based on the following provisions in the SRC:

"SEC. 53. *Investigations, Injunctions and Prosecution of Offenses* . - 53.1. The Commission may, in its discretion, make such investigations as it deems necessary to determine whether any person has violated or is about to violate any provision of this Code, any rule, regulation or order thereunder, or any rule of an Exchange, registered securities association, clearing agency, other self-regulatory organization, and may require or permit any person to file with it a statement in writing, under oath or otherwise, as the Commission shall determine, as to all facts and circumstances concerning the matter to be investigated. The Commission may publish information concerning any such violations, and to investigate any fact, condition, practice or matter which it may deem necessary or proper to aid in the enforcement of the provisions of this Code, in the prescribing of rules and regulations thereunder, or in securing information to serve as a basis for recommending further legislation concerning the matters to which this Code relates: *Provided, however,* That any person requested or subpoenaed to produce documents or testify in any investigation shall simultaneously be notified in writing of the purpose of such investigation: *Provided, further,* That all criminal complaints for violations of this Code, and the implementing rules and regulations enforced or administered by the Commission shall be referred to the Department of Justice for preliminary investigation and prosecution before the proper court: *Provided, furthermore,* That in instances where the law allows independent civil or criminal proceedings of violations arising from the same act, the Commission shall take appropriate action to implement the same: *Provided, finally,* That the investigation, prosecution, and trial of such cases shall be given priority.

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53.3. Whenever it shall appear to the Commission that any person has engaged or is about to engage in any act or practice constituting a violation of any provision of this Code, any rule, regulation or order thereunder, or any rule of an Exchange, registered securities association, clearing agency or other self-regulatory organization, it may issue an order to such person to desist from committing such act or practice: *Provided, however,* That the Commission shall not charge any person with violation of the rules of an Exchange or other self regulatory organization unless it appears to the Commission that such Exchange or other self-regulatory

organization is unable or unwilling to take action against such person. After finding that such person has engaged in any such act or practice and that there is a reasonable likelihood of continuing, further or future violations by such person, the Commission may issue *ex-parte* a cease and desist order for a maximum period of ten (10) days, enjoining the violation and compelling compliance with such provision. The Commission may transmit such evidence as may be available concerning any violation of any provision of this Code, or any rule, regulation or order thereunder, to the Department of Justice, which may institute the appropriate criminal proceedings under this Code.

SEC. 54. *Administrative Sanctions.* - 54.1. If, after due notice and hearing, the Commission finds that: (a) There is a violation of this Code, its rules, or its orders; (b) Any registered broker or dealer, associated person thereof has failed reasonably to supervise, with a view to preventing violations, another person subject to supervision who commits any such violation; (c) Any registrant or other person has, in a registration statement or in other reports, applications, accounts, records or documents required by law or rules to be filed with the Commission, made any untrue statement of a material fact, or omitted to state any material fact required to be stated therein or necessary to make the statements therein not misleading; or, in the case of an underwriter, has failed to conduct an inquiry with reasonable diligence to insure that a registration statement is accurate and complete in all material respects; or (d) Any person has refused to permit any lawful examinations into its affairs, it shall, in its discretion, and subject only to the limitations hereinafter prescribed, impose any or all of the following sanctions as may be appropriate in light of the facts and circumstances:

(i) Suspension, or revocation of any registration for the offering of securities;

(ii) A fine of no less than Ten thousand pesos (P10,000.00) nor more than One million pesos (P1,000,000.00) plus not more than Two thousand pesos (P2,000.00) for each day of continuing violation;

(iii) In the case of a violation of Sections 19.2, 20, 24, 26 and 27, disqualification from being an officer, member of the Board of Directors, or person performing similar functions, of an issuer required to file reports under Section 17 of this Code or any other act, rule or regulation administered by the Commission;

(iv) In the case of a violation of Section 34, a fine of no more than three (3) times the profit gained or loss avoided as a result of the purchase, sale or communication proscribed by such Section; and

(v) Other penalties within the power of the Commission to impose.

54.2. The imposition of the foregoing administrative sanctions shall be without prejudice to the filing of criminal charges against the individuals responsible for the violation.

54.3. The Commission shall have the power to issue writs of execution to enforce the provisions of this Section and to enforce payment of the fees and other dues collectible under this Code."

A copy of your letter was already indorsed to the EPD for appropriate action.

As to your last question regarding the matter of the jurisdiction of the Commission over the issue at hand, the answer lies in Section 143 of the Corporation Code that provides:

"Sec. 143. ***Rule-making power of the Securities and Exchange Commission.*** – The Securities and Exchange Commission shall have the power and authority to implement the provisions of this Code, and to promulgate rules and regulations reasonably necessary to enable it to perform its duties hereunder, particularly in the prevention of fraud and abuses on the part of the controlling stockholders, members, directors, trustees or officers."

Also, under Section 5 of the SRC, the Commission shall have, among others, the following powers and functions:

"(a) Have jurisdiction and supervision over all corporations, partnerships or associations who are the grantees of primary franchises and/or a license or permit issued by the Government;

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This Opinion is based solely on the facts disclosed in the query and relevant solely to the particular issues raised therein. It shall likewise be understood that the foregoing shall not be used in the nature of a standing rule binding upon the Commission in other cases or upon the courts. If, upon investigation, it will be disclosed that the facts relied upon are different, this opinion shall be rendered void.

Please be guided accordingly.

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Copy furnished:

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