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

OFFICE OF THE GENERAL COUNSEL

18 November 2014

SEC-OGC Opinion No. 14-33
Forced Acquisition of Foreign-Held Shares of Stock in an Educational Institution

ATTY. JOHN PHILIP C. SIAO
ATTY. ROANNE J. ARROLA
TIONGCO SIAO AND BELLO
Unit 1114 Medical Plaza Building
San Miguel Avenue, Ortigas Center
1605 Pasig City

Sir:

This refers to your letter request for legal opinion dated July 15, 2013 concerning your client, Philadelphia School Incorporated ("Philadelphia"), requesting for a legal opinion as to whether or not the corporation *"can **forcibly acquire** the shares of existing foreign stockholders in equal proportion up until the foreign ownership is reduced to 40% at market value or book value of the corporation."*

You stated that Philadelphia is an educational institution registered with the Commission, which has an outstanding capital stock of 4,500 shares, of which 2,300 shares, or 51.11% thereof, is owned and held by foreigners, contrary to the nationality restrictions under the Constitution.[1]

To this end, Philadelphia seeks to comply with the 60%-40% equity requirement. However, according to you, the foreign stockholders of the corporation refuse to voluntarily divest their shares. Hence, the present query.

We find your position, that the corporation may ***"forcibly acquire"*** the shares of the corporation from its stockholders, untenable. Section 63 of the Corporation Code expressly provides that shares of stock **are personal properties of the stockholders**. Thus, the corporation, not even the State, can forcibly acquire, confiscate or sequester

[1] Article XIV, Section 4 (2), of the 1987 Constitution: "(2) Educational institutions, other than those established by religious groups and mission boards, **shall be owned solely by citizens of the Philippines or corporations or associations at least sixty per centum of the capital of which is owned by such citizens.** The Congress may, however, require increased Filipino equity participation in all educational institutions. xxx"

such shares of stock without due process of law, as it partakes of a property right protected by the Constitution.[2]

Even when the consent is secured, the corporation can buy its shares only if it is compliant with Section 41 of the Corporation Code.[3] Thus:

> "*SECTION 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."
>
> (Emphasis and underscoring supplied)

For a corporation to be able to acquire its own shares, the following conditions must be present: (1) it is for a legitimate and proper corporate purpose; (2) there shall be an unrestricted retained earnings to purchase the same and its capital is not thereby impaired;[4] (3) the corporation acts in good faith and without prejudice to the rights of creditors and stockholders; and (4) the conditions of corporate affairs warrant it.[5] If the aforementioned conditions are present, a corporation may acquire the shares of its alien stockholders to comply with the constitutional requirements prescribing the minimum capital stock ownership of Filipino citizens in educational institutions.[6]

While it would appear that the conditions of Philadelphia warrant the acquisition of its own shares held by its foreign stockholders, it is imperative that there must be **unrestricted retained earnings** before it may purchase its own shares. Otherwise, this would lead to an unauthorized increase of shares of stock, as well as it constitutes violation of the trust fund doctrine. The rationale for this is that share repurchases constitute in effect a distribution to the stockholders which, if abused and without proper safeguards, will deplete and impair the assets of the corporation, to the prejudices of the stockholders and creditors of the corporation.[7] While there are other exceptions to the rule

---

[2] Article III, Section 1, 1987 Constitution: "*No person **shall be deprived*** of life, liberty, or **property without due process of law** xxx"

[3] De Leon, Corporation of the Philippines Annotated (2002 ed.), p. 373, citing SEC Opinion dated August 11, 1961.

[4] *Primer on the Corporation Code of the Philippines*, published by the Securities and Exchange Commission, p. 62.

[5] Ibid., p. 374-375; SEC-OGC Opinion No. 11-09, May 8, 2009, addressed to Villanueva Gabionza & De Santos.

[6] De Leon, supra, p. 375.

[7] II Lopez, Corporation Code of the Philippines (1994 ed.), p. 584.

requiring unrestricted retained earnings in the self-acquisition of shares,[8] it must be emphasized that nothing in the said exceptions suggests that a corporation may acquire its own shares from its stockholders by force.

Your reliance on SEC Opinion dated July 1, 1993 is misplaced. It was stated in that Opinion that if a disqualified stockholder of a rural bank fails to dispose of his shares, the corporation may *"re-acquire the same"* and that *"it may be treated as treasury shares"*. In this regard, treasury shares are shares of stock which have been issued and fully paid for, but subsequently reacquired by the issuing corporation by purchase, redemption, donation or ***through some other lawful means***.[9] The said SEC Opinion did not suggest a forced or automatic acquisition of shares - such acquisition must be done through **lawful means** as contemplated in the Corporation Code.

We trust that while this matter is resolved, Philadelphia is not operating as an educational institution. Otherwise, the Commission would monitor, sanction and penalize Philadelphia for violation of the Corporation Code of the Philippines in relation to Article XIV, Section 4 (2), of the 1987 Constitution,[10] in line with its stringent compliance of corporations with the ownership requirements in the Constitution and/or existing laws by corporations engaged in nationalized or partly nationalized activities.[11]

It shall be understood that the foregoing opinion is rendered 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 courts, or upon the Commission in other cases of similar or dissimilar circumstances.[12] If upon investigation, it will be disclosed that the facts relied upon are different, this opinion shall be rendered null and void.

CARLOS S. CORREA
General Counsel

/wsg

---

[8] (a) in the case of Treasury Shares under Section 9 of the Corporation Code; (b) with respect to redeemable shares under Section 8 of the Corporation Code; (c) to effect a decrease in the capital stock of the corporation; and (d) deadlock with respect to a management of business under a close corporation under Section 104 of the Corporation Code. (De Leon, supra, p. 374; Section III, CCP No. 1 on Rules Governing Redeemable and Treasury Shares.)

[9] Section 9, Corporation Code.

[10] "*Section 15. Forms of Articles of Incorporation.* – xxx

xxx

"(Corporations **which will engage in any business or activity reserved for Filipino citizens** shall provide the following): No transfer of stock or interest **which shall reduce the ownership of Filipino citizens** to **less than the required percentage of the capital stock as provided by existing laws** shall be allowed or permitted to be recorded in the proper books of the corporation and this restriction shall be indicated in all stock certificates issued by the corporation."

[11] SEC Memorandum Circular No. 8, Series of 2013.

[12] SEC Memorandum Circular No. 15, series of 2003.