Republic of the Philippines
Department of Finance
Securities and Exchange Commission

OFFICE OF THE GENERAL COUNSEL

13 March 2019

SEC-OGC Opinion No. 19-15
Re: Pre-emptive right

MR. JOSEPH ELTON SALIMBANGON
President and CEO
Baystreet Development Corporation
31-A. Pres. Magsaysay St.,
Kasambangan, Cebu City

Dear Mr. Salimbangon:

This refers to your letter dated 19 February 2018 inquiring on how to maintain the proportionate interest of Baystreet Development Corporation (BDC) in Ron Daniell Construction Corporation (RDCC) in case the latter issues additional shares.

Background

You stated that a Sale and Purchase Agreement (SPA) between Rodolfo B. Tumbaga (the Seller) and BDC (the Buyer) was executed on 6 December 2017 for the ninety percent (90%) shares in RDCC which amounts to ninety-nine million pesos (PhP99,000,000.00). BDC has already paid a total of thirty-two million pesos (P32,000,000.00) to the Seller which is equivalent to 29.10% of the shares in RDCC.

You further disclosed that RDCC received a mandate from the Philippine Contractors Accreditation Board (PCAB) to increase its capitalization to one hundred eighty million pesos (P180,000,000.00) to maintain its Triple A Accreditation. RDCC plans to issue a new set of shares to increase its capitalization to meet the PCAB requirement.

You therefore would like to know:

1. How to ensure that BDC's interest is protected and would not be diluted in the event that RDCC issues additional shares;
2. How to secure that RDCC is only selling to BDC aside from holding its commitment to sell the 90% share to BDC; and

3. How to execute the SPA in the event of breach of Rodolfo B. Tumbaga as the Attorney-in-Fact of all shareholders in RDCC in terms of honoring their commitment to sell the 90% share to BDC.

Opinion

As to your first query, BDC may maintain its proportionate interest in RDCC by exercising its pre-emptive right. Pre-emptive right refers to the right granted to the stockholders to have the first option to subscribe to any issuance or disposition of shares from the capital stock in proportion to their respective shareholdings in the corporation.

Under the Corporation Code (Code), the grant of pre-emptive right is mandatory, except in those situations enumerated therein, to wit:

> "Section 39. *Power to deny pre-emptive right.* - All stockholders of a stock corporation shall enjoy pre-emptive right to subscribe to all issues or disposition of shares of any class, in proportion to their respective shareholdings, unless such right is denied by the articles of incorporation or an amendment thereto: Provided, That such pre-emptive right shall not extend to shares to be issued in compliance with laws requiring stock offerings or minimum stock ownership by the public; or to shares to be issued in good faith with the approval of the stockholders representing two-thirds (2/3) of the outstanding capital stock, in exchange for property needed for corporate purposes or in payment of a previously contracted debt."

Unless denied in the articles of incorporation, or the issuance of shares falls under any of the exceptions enumerated under Section 39 of the Code, all existing stockholders of record are entitled to exercise their pre-emptive right to subscribe to all issues and disposition of shares of any class of the unsubscribed portion of the authorized capital stock or increase of authorized capital stock of the corporation in proportion to their present stockholdings. The underlying basis of this right is to maintain the proportionate interest and voting strength of existing stockholders in the corporation.[1]

This right is based on the principle that a stockholder, in subscribing to shares of stock, does so under the understanding that his equity is fixed by the relation which the number of shares he subscribes bears to the total authorized capital stock, issued or unissued, subscribed or unsubscribed, at the time of his subscription, as shown in the company's articles of incorporation, and should not, therefore, be diluted by the issuance of

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[1] SEC Opinion dated 23 March 1998 addressed to Mr. Alfredo C. Antonio; SEC Opinion dated 6 December 1994 addressed to Atty. Marcial O.T. Balgos; SEC Opinion dated 30 September 1992 addressed to Industrial Security Consultation and Management; SEC Opinion dated 7 August 1991 addressed to Atty. Fe Delos Santos-Quiaoit; SEC Opinion dated 10 July 1991 addressed to Rodolfo D. Jularbal; SEC Opinion dated 16 May 1991 addressed to Atty. Fernando P Perito; SEC Opinion dated 25 January 1990 Mr.. Pedro M. Alaras

additional shares as to affect his rights to vote, to dividends, and to the distribution of assets upon liquidation, without first giving him the opportunity to subscribe to such shares in proportion to his shareholdings.[2]

All stockholders whose names appear in the stock and transfer book of the corporation on the date of the meeting authorizing the issuance of shares are entitled to the pre-emptive right under Section 39 of the Code.[3]

Thus, in the absence of any provision in RDCC's Articles of Incorporation denying pre-emptive rights to its shareholders and provided the issuance of shares does not fall under any of the exceptions enumerated under Section 39 of the Code, BDC, as long as it is already a stockholder of record, is entitled to exercise its pre-emptive right to subscribe to additional shares of stock in proportion to its present stockholdings, in the event RDCC issues a new set of shares.

As for your second and third queries, please be informed that under Section 5 of SEC Memorandum Circular No. 5, Series of 2003 ("Memo No. 5"), it is provided that:

> "5. As a matter of policy, the Commission shall refrain from rendering opinion on the following:
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> xxx xxx xxx;
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> 5.2 Matters which involve the substantive and contractual rights of private parties who would, in all probability, contest the same in court if the opinion turns out to be adverse to their interest;
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> 5.3 Matters which would necessarily require a review and interpretation of contracts or an opinion on the validity of contracts since interpretation of contract is justiciable in nature and contract review calls for legal examination of contract on a general basis and not on specific legal issues;
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> xxx xxx xxx;
>
> 5.10 The request will entail gathering of legal materials or writing abstract essay for the requesting party since the Commission should not function or resemble as legal counsel of private firms;
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> xxx xxx xxx."

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[2] Ruben E. Agpalo, Comments on the Corporation Code of the Philippines (Rex Priniting Company, Inc.: Quezon City, 2002), p. 211.

[3] SEC Opinion dated 1 October 1981 addressed to Mr. Fernando C. Santico

Considering that your last two queries affect substantive and contractual rights of private parties, entails interpretation of contracts, i.e. Sale and Purchase Agreement, and will constrain us to act as private legal counsel, the same falls within the ambit of the afore-quoted provisions of Memo Circular No. 5.

It shall be understood, however that the foregoing opinion is rendered based solely on the facts and circumstances disclosed and relevant solely to the particular issue raised therein. It shall not be used in the nature of a standing rule binding upon the Commission in other cases or upon the courts whether of similar or dissimilar circumstances. [4] If, upon further inquiry or investigation, it will be disclosed that the facts relied upon are different, this opinion shall be rendered void.

Please be guided accordingly.

CAMILO S. CORREA
General Counsel

[4] SEC Memorandum Circular 2003-15, No. 7