



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

OFFICE OF THE GENERAL COUNSEL

13 August 2009

SEC-OGC Opinion No. 09-21
Redemption of Preferred
Shares; Treasury shares

KEPCO PHILIPPINES CORPORATION

18th Floor, Citibank Tower
8741 Paseo De Roxas
Makati City 1227

Attention: Atty. Ricardo A. Galano III
Corporate Counsel

Gentlemen:

This refers to your letter dated 30 June 2009 requesting confirmation that redemption of preferred shares issued by KEPCO Philippines Corporation (KEPHILCO), which would be classified as treasury shares, would not result in partial liquidation of the corporation.

As disclosed in your letter, KEPHILCO was registered with the Commission in 1995 with an authorized capital stock of Php105,000,000.00 divided into 10,500,000 common shares with a par value of Php10.00 per share. In 1998, KEPHILCO increased its authorized capital stock to Php1,383,750,000.00 reclassified and divided into:

1. 10,500,000 common shares with a par value of Php10.00 per share; and
2. 127,875,000 redeemable preferred shares with a par value of Php10.00 per share.

KEPCO International Hong Kong Ltd. (KEPCO H.K.), which subscribed to all the preferred shares that were issued by KEPCO, proposes to surrender the 127,875,000 redeemable preferred shares and the shares will be classified as treasury shares in accordance with the amended Articles of Incorporation dated 27 December 2007 of KEPHILCO.

It is your position that redemption of preferred shares, which are thereafter classified as treasury shares, even if such redemption results in the reduction of the

subscribed capital, will not result in the partial liquidation of KEPHILCO and as such there is no need to reduce the capital stock of the corporation.

Relevant to your query is the provision of the Corporation Code on redeemable shares, which reads:

"SECTION 8. Redeemable shares.— Redeemable shares may be issued by the corporation when expressly so provided in the articles of incorporation. They may be purchased or taken up by the corporation upon the expiration of a fixed period, *regardless of the existence of unrestricted retained earnings* in the books of the corporation, and upon such other terms and conditions as may be stated in the articles of incorporation, which terms and conditions must also be stated in the certificate of stock representing said shares.(n)" (Italics supplied)

On the other hand, the Seventh Article of the Articles of Incorporation of KEPCO provides:

"THE PREFERRED SHARES OF STOCK SHALL HAVE VOTING RIGHTS, CUMULATIVE PREFERENCE IN DIVIDEND DISTRIBUTION AND SHALL BE REDEEMED ON THE DATE AT THE OPTION OF THE STOCKHOLDERS ON RECORD AND THE REDEMPTION VALUE SHALL NOT BE LOWER THAN PAR VALUE. ONCE REDEEMED, THE PREFERRED SHARES SHALL BE CLASSIFIED AS TREASURY SHARES."

The Rules Governing Redeemable and Treasury Shares¹ ("SEC Rules," for brevity) are likewise instructive on this point, to wit:

"Treasury shares do not revert to the unissued shares of the corporation but are regarded as property acquired by the corporation which may be reissued or sold by the corporation at a price to be fixed by the Board of Directors; provided, however, that in the case of redeemable shares reacquired, the same shall be considered retired and no longer issuable, unless otherwise provided in the Articles of Incorporation."² (Underscoring supplied)

Treasury shares can still be reissued or sold by a corporation. It is only upon retirement of these treasury shares that they lose their status, either as outstanding or unissued authorized capital stock, and the number of authorized shares of capital stock of the corporation is reduced accordingly. As the Acting General Accountant of this Commission opined, the redemption of the preferred shares will not result in the decrease of the subscribed capital stock since the purchased shares remain as subscribed capital stock.³

While a corporation under its articles of incorporation is allowed to redeem its preferred shares, such redemption should be made in accordance with applicable existing laws and terms and conditions imposed in the articles of incorporation, and

¹ Corporation Code of the Philippines (CCP) No. 1 (1982).

² Section 3.2 CCP, supra.

³ Memorandum dated 24 July 2009 from the Office of the General Accountant.

should not be violative of the 'trust fund doctrine.'⁴ The Supreme Court discussed the nature of redeemable shares in the case of *Republic Planters Bank v. Agana*⁵ in this wise:

"Redeemable shares, on the other hand, are shares usually preferred, which by their terms are redeemable at a fixed date, or at the option of either issuing corporation, or the stockholder, or both at a certain redemption price. A redemption by the corporation of its stock is, in a sense, a repurchase of it for cancellation. The present Code allows redemption of shares even if there are no unrestricted retained earnings on the books of the corporation. This is a new provision which in effect qualifies the general rule that the corporation cannot purchase its own shares except out of current retained earnings. However, while redeemable shares may be redeemed regardless of the existence of unrestricted retained earnings, this is subject to the condition that the corporation has, after such redemption, assets in its books to cover debts and liabilities inclusive of capital stock. *Redemption, therefore, may not be made where the corporation is insolvent or if such redemption will cause insolvency or inability of the corporation to meet its debts as they mature.*" (Italics supplied)

Moreover, for the protection of the stockholders, the SEC Rules provide that a corporation that has issued redeemable shares shall set up and maintain a sinking fund to be deposited with a trustee bank which shall not be invested in risky and speculative ventures.⁶ A sinking fund refers to a fund set up by a corporation where cash is gradually set aside in order to accumulate the amount necessary to meet the redemption price of redeemable shares at specified dates in the future.⁷

As a final note, the redemption of shares must be made in good faith and without prejudice to the rights of other creditors or shareholders.⁸ Otherwise, the redemption may not be undertaken or if it has already taken place, the other creditors or shareholders may have a cause of action for the recovery of the assets of the corporation, which were used to redeem its own shares.

Based on the evaluation of the 2007 Audited Financial Statements of KEPHILCO, the following are the findings of the Office of the General Accountant of the Commission:

1. It appears that the redemption of the P127,875,000 worth of preferred shares has already been made. The issued capital stock per the *Statement of Changes in Equity* as of December 31, 2007, only pertains to the 103,825,000 common shares;
2. The redemption was not made in accordance with the KEPHILCO's Articles of Incorporation xxx due to the following findings:

¹ SEC Opinion dated 25 June 1991 addressed to Mr. Jess G. Tabora.

² G.R. No. 51765, 03 March 1997.

⁶ Section 5.4, SEC Rules.

⁷ Section 2.d, *supra*

⁸ Ballantine on Corporations, p. 608 (1946).

- a. The P127,875,000 worth of preferred shares was eliminated from the issued capital stock, making it appear that the said shares were retired which is not consistent with the articles of KEPHILCO;
- b. There is no recognition of the total cost of treasury preferred shares as a deduction from the equity; xxx

In view of the foregoing, we could not confirm that the redemption of preferred shares issued by KEPHILCO did not result in the partial liquidation of the corporation. The lack of recognition of treasury shares in the equity of KEPHILCO deviates from the requirement that would allow us to opine otherwise.

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.⁹ 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.



VERNETTE G. UMALI-PACO
General Counsel

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⁹S.E.C Memorandum Circular No. 15 dated 16 December 2003.