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

OFFICE OF THE GENERAL COUNSEL

31 March 2016

SEC-OGC Opinion No. 16-05
RE: Indivisibility of subscription contract; Payment of Balance of Unpaid Subscriptions; Delinquent Shares; Delinquency Sale

ESTELITA Y. SY
Corporate Secretary
RURAL BANK OF MAASIN (SOUTHERNLEYTE), INC.
E. Rafols St., Tunga-tunga,
Maasin City, Southern Leyte

Madam:

This refers to your letter dated 17 August 2015 requesting for a legal opinion on various matters, particularly on making of calls for payment of subscription on installment basis, indivisibility of subscription contract, payment of the balance of unpaid subscriptions, delinquent shares and delinquency sale.

You mentioned in your letter that the Board of Directors of the Rural Bank of Maasin (Southern Leyte), Inc. (the Corporation, for brevity) is contemplating to make a call for the payment of the subscription for all stockholders on installment basis; that a certain percentage of the unpaid subscriptions shall be declared due and payable at different dates. Consequently, you requested clarification and/or confirmation on the following:

1. Whether or not calls for the balance of subscriptions may be made by installments;

2. Whether or not stock certificates may be issued for the equivalent of the shares partially paid in a subscription, even if the whole subscription has yet to be fully paid or cannot be fully paid by the subscriber;
3. Whether or not cash or stock dividends may be used to pay the balance of unpaid subscriptions;

4. Whether or not the whole subscription becomes delinquent upon a stockholder's failure to pay an installment pursuant to a call for payment of the balance of subscription by installment; and

5. Whether the procedure for the delinquency sale prescribed in Sec. 68 of the Corporation Code (the Code) is mandatory in such a manner that the board of directors of a corporation is precluded from adopting a different procedure.

I. Whether or not calls for the balance of subscriptions may be made by installment.

In your letter, you asked for confirmation whether, as provided for under Section 67 of the Code, a call for payment for the balance of subscriptions may be made by installments.

The second paragraph of Section 67 provides:

"Payment of any unpaid subscription or any percentage thereof, together with the interest accrued, if any, shall be made on the date specified in the contract of subscription or on the date stated in the call made by the board. Failure to pay on such date shall render the entire balance due and payable and shall make the stockholder liable for interest at the legal rate on such balance, unless a different rate of interest is provided in the by-laws, computed from such date until full payment. If within thirty (30) days from the said date no payment is made, all stocks covered by said subscription shall thereupon become delinquent and shall be subject to sale as hereinafter provided, unless the board of directors orders otherwise."

Thus, calls for the payment of the balance of the subscription maybe made on installment, because the Code itself provides that the contract of subscription or the call by the board of directors, as the case may be, may require the payment of the entire unpaid subscription or only a certain percentage thereof on the date specified for payment.¹

We, therefore, answer your first query in the affirmative.

It is worth noting, however, that Section 67 does not give the Board of Directors absolute power to make a call for the payment of the unpaid subscription. The first paragraph of Section 67², in relation to Section 13³

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² Section 67: Payment of balance of subscription.- Subject to the provisions of the contract of subscription, the board of directors of any stock corporation may at any time
of the Code, succinctly provides that the call for the payment of the unpaid subscriptions is required only when there is no fixed date for payment in the contract of subscription; otherwise, no amount of calls from the board will make the subscription due and payable until the arrival of the fixed date provided for in the subscription contract.

II. Whether or not stock certificates may be issued for the equivalent of the shares partially paid in a subscription even if the whole subscription has yet to be fully paid or cannot be fully paid by the subscriber.

As you mentioned, the Corporation understands that: (a) a subscription is one, entire, and indivisible whole contract based on the import of Section 64 of the Code which states that “no certificate of stock shall be issued to a subscriber until the full amount of his subscription together with the interest and expenses (in case of delinquent shares), if any is due, has been paid”, and (b) the principle of indivisibility of subscription is absolute as Section 64 of the Code speaks of no exception. You thereby request for interpretation of the foregoing principles in relation to the following:

1. Whether stock certificates may be issued representing the amount equivalent to subscriptions partially paid despite the balance being unpaid and/or cannot be fully paid by a subscriber; and

2. Whether a stockholder may assign the balance of the subscription to a third person in such a manner that the stock certificates will be issued to the stockholder for the paid portion and the balance to the third person who assumes the payment of the balance of the subscription.

As to your first sub-query, we answer it in the negative. To amplify, the Commission consistently opined that a stockholder shall only be entitled to the issuance of his certificate of stock upon payment of the full amount of his subscription together with the interest and expenses (in case of delinquent shares), if any is due. This is pursuant to the doctrine of indivisibility of the subscription contract implicitly set forth under Section 3

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3 Section 13. Amount of capital stock to be subscribed and paid for the purposes of incorporation. — At least twenty-five percent (25%) of the authorized capital stock as stated in the articles of incorporation must be subscribed at the time of incorporation, and at least twenty-five (25%) per cent of the total subscription must be paid upon subscription, the balance to be payable on a date or dates fixed in the contract of subscription without need of call, or in the absence of a fixed date or dates, upon call for payment by the board of directors: Provided, however, That in no case shall the paid-up capital be less than five Thousand (P5,000.00) pesos.

4 Citing SEC Opinion dated 03 September 1982 addressed to Mr. Adolfo Martinez.

5 SEC Opinion dated 06 March 2006 addressed to Atty. Roderick R.C. Salazar III.
64 of the Code, that is, a subscription is one, entire and indivisible contract. It cannot be divided into portions so that the stockholder shall not be entitled to a certificate of stock until he has remitted the full payment of his subscription together with the interest and expenses if any is due. The purpose of the prohibition is to prevent the partial disposition of a subscription which is not fully paid, because if it is permitted, and the subscriber subsequently becomes delinquent in the payment of his subscription, the corporation may not be able to sell as many as his subscribed shares as would be necessary to cover the total amount due from him, which is authorized under Section 68.7

As to your second sub-query, we also answer in the negative. Again, because of the principle of the indivisibility of subscription under Section 64 of the Code, the subscription cannot be divided into portions. In one instance, the Commission opined that:

"Accordingly, if the stockholder has not paid the full amount of his subscription, he cannot transfer part of it in view of the indivisible nature of subscription contract. It is only upon full payment of the whole subscription that a stockholder can transfer the same to several transferees.8 However, the entire subscription, although not yet fully paid, may be transferred to a single transferee, who as a result of the transfer, must assume the unpaid balance. It is necessary, however, to secure the consent of the corporation since the transfer of subscription right contemplates a novation of contract which under Article 1293 of the Civil Code of the Philippines cannot be made without the consent of the creditor."9

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6 SEC Opinion dated 23 April 2010 addressed to Dr. Federico A. Arcenas, citing SEC Opinion dated April 11, 1994 addressed to Mr. Gonzales M. Mallari.
7 See note 1, at 587.
8 The reason behind the principle disallowing transfer of not fully paid subscription to several transferees is that it would be difficult to determine whether or not the partial payments made should be applied as full payment for the corresponding number of shares which can only be covered by such payment or as proportional payment to each and all of the entire number of subscribed shares. Consequently, it would be difficult to determine the unpaid balance to be assumed by each transferee. Thus, it is only upon full payment of the whole subscription that a stockholder can transfer the same to several transferees. (SEC Opinion dated 9 October 1995 address to Atty. A.B.F. Gaviola, Jr. citing SEC Opinion dated March 8, 1990 addressed to Mr. Manuel R. de Jesus; SEC Opinion dated 3 June 1994 addressed to Concepcion Madarang; SEC Opinion dated September 17, 1990 addressed to Atty. Luciano S. Borja)
9 See note 6, citing SEC letter dated January 6, 1983 addressed to Bay Sunset Tours & Travel Corporation and SEC Opinion dated April 11, 1994 addressed to Mr. Gonzales M. Mallari.
III. Whether or not cash or stock dividends may be used to pay the balance of unpaid subscriptions.

In your letter, you stated your position that under Section 43 of the Code, the only time cash dividends may be applied to an unpaid subscription is when the stocks have been declared delinquent. Hence, you raised the following sub-queries:

1. Whether cash dividends may be applied to the balance of a non-delinquent subscription; and
2. Whether stock dividends may be used to pay the balance of the unpaid subscriptions.

We answer the first sub-query in the negative. Cash dividends cannot be withheld from the subscribers who have not fully paid their subscriptions unless they are delinquent on their unpaid subscriptions.\(^{10}\) Basically, this is because the balance of the unpaid subscription is not yet due and demandable. The corporation may use the cash dividends to pay off stockholders' subscription but which have not been declared delinquent only if the stockholders concerned give their consent thereto.\(^{11}\)

As to your second sub-query, we likewise answer in the negative. A stockholder's indebtedness to a corporation under a subscription agreement cannot be compensated with the amount of his shares in the same corporation, there being no relation of creditor and debtor with regard to such share. Under Section 43 (par. 1), "stock dividends shall be withheld from the delinquent stockholder until his unpaid subscription is fully paid." In other words, under the said provision, it is not allowed to apply stock dividend to unpaid subscription.\(^{12}\)

Moreover, it should be noted that the "declaration of stock dividend involves the creation and issue of new shares of stock. The basis of the issue, insofar as payment into the corporation is not required of the recipient, is surplus assets which thus become converted into strict capital with all which that implies." Thus, a stock dividend which requires a transfer of surplus to capital account cannot be made without issuing new shares. Considering that the retained earnings/profits are already applied as payment to the new issuance of shares, the same cannot be reapplied to previous subscriptions which are still unpaid. Likewise, to allow the stocks issued pursuant to the declaration of stock dividend as payment to unpaid subscription would be, in effect, re-acquiring its own shares, the proceeds of which will be applied to the unpaid subscription, which case is not allowed under Section 41 of the Code which enumerates the instances and

\(^{10}\) SEC Opinion dated 08 March 1991 addressed to China Banking Corporation.
\(^{11}\) Ibid.
\(^{12}\) See note 1, at 415.
conditions wherein a corporation can legally purchase or acquire its own shares.\textsuperscript{13}

\section*{IV. Whether or not the whole subscription becomes delinquent upon a stockholder’s failure to pay an installment pursuant to a call for payment of the balance of subscription by installment.}

You requested that the following sub-queries be addressed:

1. Does the subscription become automatically delinquent within 30 days from the date stated in the call should the stockholder fail to pay?
2. What is the meaning of the word “unless the board of directors orders otherwise”? Does it authorize the board of directors of a corporation to remove the delinquency status of a particular subscription while not lifting the status of subscriptions similarly situated?
3. Should a stockholder fail to pay an installment within 30 days from the date stated in the call made by the board of directors, does that render the whole subscription delinquent or just the portion/percentage of the subscription which becomes due and payable?

On the first sub-query, the answer is in the affirmative. There is no need of a formal declaration of the Board for an unpaid subscription to become delinquent in the event of failure to pay the unpaid subscription within the prescribed 30 day period from the date specified in the subscription contract or the date stated in the call.\textsuperscript{14} Henceforth, the subscription becomes automatically delinquent upon the lapse of the 30 day period stated in the call, with the stockholder failing to pay.

Relative to your second sub-query, the Code provides:

"SECTION 67. Payment of balances of subscription. . . . If within thirty (30) days from the said date no payment is made, all stocks covered by said subscription shall thereupon become delinquent and shall be subject to sale as hereinafter provided, unless the board of directors orders otherwise." (Emphasis supplied)

Under the above provision, the phrase “unless the board orders otherwise” means that the board of directors may order the removal of the


\textsuperscript{14} SEC Opinion dated 13 March 1998 addressed to Atty. Jose A. Feria Jr.
delinquent status of unpaid subscription. Unless, there is such an order from the board, its delinquent status remains.\textsuperscript{15}

As to whether the removal of the delinquency status could be applied only to a particular subscription, it has been held that a call made upon some of the subscribers is void or which requires some to pay a higher rate than the others, pursuant to the rule that calls must operate uniformly upon all shareholders. A call cannot be of such a character as to permit the directors to practice favoritism or act oppressively.\textsuperscript{16} In like manner, if a call cannot be made discriminatorily, so should the removal of the delinquency status.

On the last sub-query, we answer in the affirmative. Failure to pay on the date fixed by the board on call of subscription shall render the entire balance due and payable and make all the stocks covered by the said subscription delinquent and subject to sale at public auction.\textsuperscript{17}

\textit{V. Whether the procedure for the delinquency sale prescribed in Sec. 68 of the Code is mandatory in such a manner that the board of directors of a corporation is precluded from adopting a different procedure.}

We answer in the affirmative.

If a stockholder fails to pay his unpaid subscription after a valid call, there are two (2) remedies under the Code for the corporation to enforce the liability. The first remedy consists of permitting the corporation to put up delinquent shares for sale under Section 68 thereof and the second one is by an action in Court to recover the unpaid subscription pursuant to Section 70 thereof. The unsuccessful attempt to follow the remedy by sale under said Section will not bar an action in Court to recover the unpaid subscription pursuant to Section 70.\textsuperscript{18}

Strict compliance with the formalities of sale under Section 68 is necessary, the power to make the sale being merely granted by law and an extra ordinary one.\textsuperscript{19} Unless the delinquent shares are sold in accordance with the said Section, the ownership thereof remains with the stockholder.\textsuperscript{20}

\textsuperscript{15} SEC Opinion dated 26 August 1992 addressed to Institute for Development Alternative.
\textsuperscript{16} See note 1, at 615, citing Seybret vs. American Commander Min. and Mill. Co., Idaho 254; Great Western Pedeg. Co. vs. Burnham, 79 Wis. 47; North Milwaukee Town Site Co. vs. Bishop, 103 Wis 492.
\textsuperscript{17} Ibid, at 614; SEC Opinion dated 23 April 2010 addressed to Dr. Federico A. Arcenas
\textsuperscript{18} SEC Opinion dated 9 October 1992 addressed to Virginia A. Maghuyop
\textsuperscript{19} See note 1, at 620, citing 4 Fletcher, at 670.
\textsuperscript{20} SEC Opinion dated 3 September 1990 addressed Dr. Raul D. Jara.
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. 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.

[Signature]
General Counsel

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