



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

13 October 2014

SEC-OGC Opinion No. 14-28
Re: SEC-OGC Opinion No. 10-21;
Interest in Co-Ownership as
Consideration for Shares of Stock

BUÑAG & LOTILLA LAW OFFICES

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Attention: Atty. Perpetuo M. Lotilla, Jr.

Sir:

This is in response to your letter dated 11 July 2013, in relation to SEC-OGC Opinion No. 10-21, specifically on the right of redemption of a co-owner over an interest in a co-owned property used as consideration for shares of stock.

In SEC-OGC Opinion No. 10-21,¹ it was opined that the transfer of interest in a co-ownership to a corporation as consideration for shares of stock is subject to the right of redemption or pre-emption under Articles 1620² and 1623³ of the New Civil Code of the Philippines, because the exchange involves a transmission of ownership by onerous title. It was opined further that the property or interest so transferred should be free from any right of redemption or pre-emption considering that the property must be in such a manner that it is capable of being applied to the payment of the corporation's debts or can be subject to levy and execution.

Thus, this Office deemed it necessary that a waiver of rights of all possible co-owners or redemptioners, or an affidavit of the transferor that all the possible co-owners or redemptioners have been notified in writing of the transfer and that the 30-day period of redemption has already expired, should be submitted in applications for registration where the payment for subscription is an interest in a co-owned property, in order to free the interest therein from any right of redemption or pre-emption.

¹ Dated 26 May 2010, addressed to Kapunan Lotilla Garcia & Castillo Law Offices.

² Article 1620 provides:

A co-owner of a thing may exercise the right of redemption in case the shares of all the other co-owners or of any of them, are sold to a third person. If the price of the alienation is grossly excessive, the redemptioner shall pay only a reasonable one."

³ Article 1623 provides:

The right of legal pre-emption or redemption shall not be exercised except within thirty days from the notice in writing by the prospective vendor, or by the vendor, as the case may be. The deed of sale shall not be recorded in the Registry of Property, unless accompanied by an affidavit of the vendor that he has given written notice thereof to all possible redemptioners.

The right of redemption of co-owners excludes that of adjoining owners. (1524a)"

It is implied in your letter that you disagree with the Opinion, and, in support of your dissent, you submitted the following arguments:

1. The Opinion expanded the coverage of Articles 1620 and 1623 of the New Civil Code. The said articles only refer to sale to third persons and do not mention transfer by onerous title. Also, as the transferee is a corporation majority owned and controlled by the transferor, the transferee is essentially not a third person;
2. The right of redemption or pre-emption does not and cannot prevent the application of the property or interest therein as payment for debts. It likewise cannot prevent levy and sale on execution. The other co-owners may only exercise their right to redeem on such cases. But should they do so, they will then have to pay for the value of the property or interest therein. Thus, the corporation will have cash arising from the redemption or pre-emption which will be used as payment for a debt or to satisfy a levy and execution.

In view of your disagreement, you asked that the subject Opinion be corrected and that the transferor should not be required to submit any waiver of the right to redemption or pre-emption executed by the other co-owners.

In previous Opinions,⁴ the Commission has discussed that interest in a co-ownership can be alienated by way of subscription to shares of stock, subject to the following conditions:

1. The property must be something which the corporation may acquire and hold in carrying out its purpose or reasonably necessary or convenient in the pursuit of its business;
2. Interest in the co-ownership must have a pecuniary value capable of ascertainment (at a fair valuation equal to the par or issued value of the stock issued);
3. The right over the property must actually be transferred to the corporation and no creditors of the property held in common shall be prejudiced by the transfer; and
4. The transfer shall be subject to Articles 1620 and 1623 of the Civil Code.

With regard to your first position, it is our view that there is NO expansion of the coverage of Articles 1620 and 1623 of the New Civil Code. First, Article 1619 of the New Civil Code provides:

Legal redemption is the right to be subrogated, upon the same terms and conditions stipulated in the contract, in the place of one who acquires a thing by purchase or dation in payment, or *by any other transaction whereby ownership is transmitted by onerous title.*

Despite the wording of Articles 1620 and 1623 that pertains only to sale, the very definition of legal redemption under Article 1619 covers transactions where ownership is transmitted through onerous title. In view thereof, to exclude this mode of transmitting ownership from the coverage of the rules on legal redemption would be absurd.

Second, the corporation is a third person, as opposed to your theory. It is well settled that a corporation registered under the Corporation Code is considered a juridical person with

⁴ SEC-OGC Opinion No. 08-02, dated 3 January 2008, addressed to Suarez & Narvasa Law Firm; SEC Opinion dated 6 November 1990, addressed to Feria, Feria, Lugtu & Lao Law Offices.

a personality separate and distinct from that of each shareholder/members. This attribute gives rise to a fundamental principle in corporation law that under normal conditions, the stockholders/members of a corporation are not the same as the corporation itself,⁵ regardless if the stockholder owns the controlling interest in a corporation.

As to your second position, we agree that the right of redemption or pre-emption does not and cannot prevent application of the property or interest therein as payment for debts, or the levy and sale on execution of the property or interest. However, as long as the right of legal redemption or pre-emption subsists, meaning, that the period to exercise the right of legal redemption or pre-emption has not yet expired or the co-owner has not waived his right prior to the lapse of said period, the purchaser or transferee is not at total liberty to dispose of the interest in the co-ownership to anyone other than the co-owners who possesses the right.

Before the end of the period within which the right to legal redemption or pre-emption may be exercised by the co-owner, the purchaser or transferee is constrained from selling or transferring the interest in the co-owned property to other persons without incurring any liability. Meaning, while the subsequent sale or transfer of the interest in the co-owned property to persons other than the co-owners will be valid if the same is made by the purchaser or transferee while the right is subsisting, the seller or transferor in the subsequent sale or transfer may be held liable for ignoring the right of the co-owners, especially when the co-owners sustain injuries arising from the subsequent sale or transfer.⁶

Consequently, the interest so acquired through purchase or transfer is not readily transferable by the buyer or transferee to persons aside from the co-owner during the existence of the right of legal redemption or pre-emption.

This runs counter to the very nature of the property to be transferred to the corporation as consideration for subscription to shares of stock, that is, the property or interest therein must be capable of being applied to the payment of the corporation's debts or can be subject to levy and sale on execution for the satisfaction of any judgment or decree against the corporation.⁷ By this it must be understood that the property transferred to a corporation as consideration for subscription must be readily transferrable (i.e., capable of being used for payment) by the corporation to any other person from the moment of transfer. To hold otherwise would be to place the corporation in a more complicated situation in the future, which is not the intention of the law.

As well, the value of the interest in the co-ownership acquired by the corporation is in effect diminished due to the limitation on the free transferability thereof for as long as the right of the co-owners in relation to the transfer to the corporation still exists.

Thus, it is important to make the interest in a co-owned property, which is used as subscription consideration, free from any right of legal redemption or pre-emption. In order

⁵ SEC Opinion dated 18 November 1998, addressed to Archt. Jaime C. Marquez.

⁶ Under Article 19 of the New Civil Code, "Every person must, in the exercise of his rights and in the performance of his duties, act with justice, give everyone his due, and observe honesty and good faith." Further, under Section 20 of the same law, "Every person who, contrary to law, willfully or negligently causes damage to another, shall indemnify the latter for the same."

⁷ §5188, 14 Fletcher Cyclopedia Corporations 413 (Permanent Ed.).

to achieve this, all the possible co-owners must waive their right to exercise legal redemption or the period within which this right may be exercised must have lapsed.

Further, where the consideration for the subscription is other than actual cash, the valuation thereof shall initially be determined by the incorporators or the board of directors, subject to approval by the Securities and Exchange Commission,⁸ in order to prevent watering of stocks.⁹ Incidental to this power of the Commission to approve the valuation of the property or interest used as subscription payment is the authority to require the submission of documents or compliance with conditions for the purpose of ensuring that the value of the property or interest therein is not below the value of the shares issued.

Accordingly, in the Opinion subject of your query, the following are required in applications for registration where the payment of subscription is an interest in a co-owned property so as to free the same from any right of legal redemption or pre-emption:

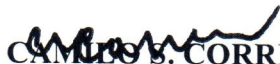
1. A Waiver of Rights signed by all possible co-owners/redemptioners stating that they are waiving their right of redemption or pre-emption *in relation to the said transfer*; or
2. An Affidavit, executed by the co-owner who exchanged his interest for the shares of stock, stating the following:
 - a. that he has given written notice thereof to all possible co-owners/redemptioners;
 - b. that the same was received by them; and
 - c. that the 30-day period of redemption has already expired.

The said Affidavit must be accompanied by a copy of the actual Written Notice to all possible co-owners/redemptioners and the Proof of Receipt by them.

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 and 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. If, upon further inquiry and investigation, it will be disclosed that the facts relied upon are different, this opinion shall be rendered void.¹⁰

Please be guided accordingly.

Very truly yours,


CAMILO S. CORREA
General Counsel


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⁸ Section 62, Corporation Code of the Philippines.

⁹ Watering of stocks is a situation wherein the consideration for subscription is not at a fair valuation equal to the par or issued value of the stock issued, contrary to Section 62, in relation to Section 65, of the Corporation Code.

¹⁰ SEC Memorandum Circular No. 15, Series of 2003.