SINGAPORE LAW WATCH
SINGAPORE DAILY LEGAL NEWS

SLW COMMENTARY

Issue 2/Apr 2017

Dual Class Shares in Singapore

LANCE LIM*

This article considers the arguments for and against dual class share structures and suggests that it would be a matter of time before Singapore adopts a suitable regulatory framework to attract top-tier companies with dual class share structures to list in Singapore with appropriate safeguards to mitigate governance risks.

Singapore and Hong Kong are reviving the debate on dual class shares which has engendered much interests amongst practitioners and academics. The Singapore Exchange ("SGX") has recently sought public feedback whether to amend its listing manual to allow the listing of companies with dual class share structures. This was following the SGX's Listings Advisory Committee ("LAC")'s ruling in favour of allowing dual class share structures to list on SGX subject to appropriate safeguards. Notably, the Committee on the Future Economy has also recommended that dual class share structures be allowed so as to widen the range of public financing options, and to support the SGX as a listing venue for companies in high-technology, bio-pharmaceutical and life sciences industries. Similarly, there is also a noticeable shift in the attitudes of the Hong Kong Exchanges and Clearing (HKEX), which has recently indicated the possibility of allowing the listing of dual class shares in Hong Kong.

With the recent amendments to the Singapore Companies Act (Cap. 50) ("Companies Act"), the previous one-share-one-vote restriction in public companies has been removed – the new section 64A of the Companies Act now allows public companies to issue shares of different classes such as those that confer special, limited, conditional voting rights or no voting rights subject to certain conditions being met. This has essentially paved the way for SGX to implement a suitable regulatory framework that would attract top-tier companies with dual class share structures to list in Singapore.

* Advocate & Solicitor of Singapore

Dual class share structures are generally characterized by two classes of shares where one class of shares with only one vote per share (i.e. the common shares usually offered to public investors) would be subordinated to a superior class of shares which entitles the holder to multiple votes per share (usually being held by founding shareholders). The result of this structure is that the founding shareholders would be given voting power or other related rights disproportionate to their shareholdings, allowing them to maintain control of the company while enabling access to capital financing. When voting interest is divorced from economic interests, this may invariably lead to corporate governance problems. However, it should be noted that the concept of shares with different voting rights is not entirely novel in Singapore – preference and non-voting shares already exist in private companies as well as certain listed companies in Singapore (such as in the form of management shares).

Notably, several jurisdictions have already jumped on this bandwagon and allow for such dual class share structures. This is seen most prominently in jurisdictions such as the United States reportedly accounting for over half of the 500-odd companies with dual class shares listing structure in the world, with the likes of Google and Facebook offering eye-catching returns. In the United Kingdom, while the one share one vote concept remains as the default principle, dual class share structures are generally permitted for standard listings as opposed to premium listings. Such structures are also adopted as common measure of protection against corporate hostile takeovers. In Australia, companies are generally allowed to issue classes of shares with different voting rights subject to the companies' articles, although listed companies are prevented from doing so under the ASX listing rules. Nearer to home, the Hong Kong Stock Exchange generally bans dual class share structures although the exchange has recently announced that it plans to consult on the launch of a third board to attract more technology and new-economy firms to list. Evidently, the concept of dual class shares remains a contentious issue in various jurisdictions and this was likewise acknowledged in our parliamentary debates in relation to the introduction of dual class share structures in Singapore. It was recognized that such structures are necessary to "maintain the relevance of Singapore as a financial hub and to maintain its competitiveness and attractiveness relative to its competitors."

The lacklustre mood of our capital markets in recent years should signal a time for a change to embrace innovative structures that could open up opportunities for Singapore. Like Hong Kong, Singapore lost out on some potential high profile listings precisely because of the structural impediments in our regulatory framework. Going forward, Singapore's nimble ability to adapt to the changing commercial landscape and to attract a broad spectrum of top-tier listings could be key in ensuring Singapore's relevance as Asia's financial hub. In view of global demands and increasingly sophisticated investors, these changes must surely be seen as steps needed to be taken to maintain Singapore's competitiveness and attractiveness relative to our competitors. It is envisaged that the removal of the one share one vote restriction will give public companies greater flexibility in raising capital and provide investors with a wider range of investment opportunities. However, it remains to be seen how would dual class share structures measure up in terms of shareholder protections? Would dual class share structures be any cause for concern for public investors in Singapore going forward?

Rethinking dual class shares structures

In dual class share structures, it may seem unfair to investors that the voting power of one's shares does not bear any reasonable correlation to the equity interest of those shares. A shareholder may have greater voting power than another even if both have the same amount of equity in the company. The removal of the one share one vote restriction risks public investors becoming disenfranchised and being relegated as second-class investors, at the mercy of those who own no more of the company than they do but have greater rights. The main conundrum facing any analysis of dual class shares is this - the advantage of a dual class share structure is that it protects entrepreneurial management from the demands of ordinary shareholders but conversely, the disadvantage of a dual class share structure is that it also protects entrepreneurial management from the demands of shareholders.

Who's in control? - entrenchment of control

The potential risk of corporate abuse is also a real one. Minority controlling shareholders with special voting rights could entrench their control of the company since by default they would be able to appoint their nominees to a majority of the board whose positions are effectively insulated from the threat of removal. Additionally, such controlling shareholders would also be able to vote down takeover proposals at general meetings at their discretion. Potentially lucrative takeovers will be next to impossible to conduct and poorly performing board or management could prove difficult to dislodge.

From a corporate governance perspective, the idea of a minority shareholder base controlling a majority of the board increases opacity and the company becomes more susceptible to corporate misconduct which casts doubt on the question of accountability. Problems that surface from controlling the vote without taking equal risk on capital might risk being papered over. Effectively, the board becomes much less of a monitor and instead this monitoring function is being 'exported' to third parties such as the government, regulators or the courts. There are concerns that this may lead to more companies going into that route of having such shareholding structures in order to fend off or retain permanent control which can be to the detriment of the rest of the public investors.

Evidently, the way dual class share capital is structured removes any incentive for board performance usually provided by the risk of being taken over. In such scenarios, the need for a stronger element of independence on the board becomes of greater significance. Independent directors must have the power to suspend management if there is any wrongdoing, fraud or dishonesty. There is a strong impetus for such possible measures to be imposed on public companies that adopt a dual class share structure. In this regard, we could draw several useful references from the revised Singapore corporate governance code in 2012 (e.g. having a criteria of independence and minimum number of independent directors etc.). One possible safeguard would be to mandate a certain number of truly independent directors who would be in charge of the nominating committee, thereby instilling some form of effective oversight and monitoring.

For investors who are not planning to be long-term investors, dual class share structures could be an obstacle to getting their way. Proponents of it commonly offer the perspective that such structures allow founding shareholders more leeway to pursue their long-term vision and protect their firm from public investors who are focused on short-term earnings. With increasingly more sophisticated and larger institutional investors who are aggressive in their attempt to influence companies' agendas but with shorter investment time horizons, companies may find dual class share structures useful in mitigating short-term shareholder influence in order to pursue their core values and long term commercial objectives.

While it may be appealing when inspiring founding visionaries are spearheading the company at its infancy stage, however, shareholders should generally have recourse and be able to hold management or the board accountable should the company heads in the wrong direction. Detractors of dual class share structures are concerned that such structures facilitate conflict of interest transactions, by permitting the board or management to engage in transactions that benefit the minority controlling shareholders at the expense of public investors without fear of any consequences. Secondly, such structures also preserve the status quo, especially where the board or management's strategic vision is failing or where bad business decisions are made. The 'minority' shareholders may often be left powerless to retaliate or effect change in both situations.

Investor awareness and pricing of dual class shares

While the concept of dual class shares is not entirely novel to companies in Singapore, such structures have not been seen to be widely adopted. There are concerns about whether investors will generally be ready for such structures and able to comprehend the nature and implications of investing in dual class share structures. In takeover situations, questions about fair value of multiple-vote ordinary shares vis-à-vis single vote ordinary shares may also arise. Nevertheless, investors in Singapore have already been investing in warrants and derivatives, as well as subscribing for shares in Google and Facebook through online stock brokers. Also, it is also commonly seen in pyramidal corporate structures and shareholder agreements (among shareholders on special voting arrangements such as veto rights or the right to appoint directors) where certain group of shareholders have weighted voting rights to retain control over key aspects of the company. Ultimately, it should also be up to the investors to decide if the risks and rewards of an investment are reciprocal – i.e. caveat emptor.

While the pricing of different classes of shares may be determined, as part of the usual valuation process, by issuing companies as well as valuation by investment banks and road shows with potential investors, it remains to be seen whether Singapore's financial markets can be efficient enough to fairly price shares with different voting rights. Ultimately, public investors will have to make a judgment call to determine whether the premiums or discounts offered represent the true and fair value for the respective classes of shares.

What about Shareholder Protection?

While shareholders should be cognizant of the inherent risks of conflict of interest that dual class shares structures may pose, they are not entirely without protection should the risks of improper management materialise. There are statutory safeguards in place to deal with corporate abuses of power.

The Companies Act, as with most company law regimes in common law jurisdictions, provides for redress where minority shareholders' rights are unfairly prejudiced (i.e. by those managing the company who possess a majority of the voting power) under section 216. While the courts may be slow to intervene in the management of the affairs of companies on the ground that 'minority' shareholders participate in a corporate entity knowing that decisions are subject to 'majority' rule, section 216 nevertheless enjoins the courts to examine the conduct of 'majority' shareholders (i.e. those managing the company who possess a majority of the voting power) to determine whether they have departed from proper standards of commercial fairness, standards of fair dealing and conditions of fair play. If it is found that the company's affairs are conducted in such manner that is oppressive to the complainant shareholders or that some resolution of the company is passed that does in fact unfairly discriminates or is otherwise prejudicial to the shareholders, the courts have a wide scope of judicial discretion to do justice and to address unfairness and inequity in corporate affairs.

Also, directors are ultimately subject to fiduciary duties to act bona fide in the best interests of the company. This is a strict equitable rule under common law that a fiduciary must act in what he honestly considers to be the company's interest and must not place himself in a position where his duty to the company and his personal interests may conflict. That said, nominee directors appointed to the board may in fact tend to act in their nominator's interests. It would be difficult to objectively ascertain whether such nominee directors do in fact subordinate their fiduciary duties as stewards of the company to the interests of the controlling shareholders.

Additionally, our listing rules under SGX (e.g. Chapter 9 – Interested Person Transactions) supplements the law governing conflict of interest and seeks to regulate and guard against the risk of possible abuse by interested persons of their position to influence the listed company, its subsidiaries, or associated companies to enter into transactions with interested persons that may adversely affect the interests of the listed company or its shareholders. For example, under Chapter 9, subject to certain exceptions, all other interested person transactions must either be announced immediately or approved by the shareholders as the case may be.

Possible safeguards

To minimise the risks of entrenchment of voting rights in a company, the LAC has recommended that the SGX adopts the following mitigating safeguards:

a. A maximum voting differential of 10:1 between shares with multiple voting rights and ordinary shares (a commonly adopted voting differential in other jurisdictions);

b. General prohibition of issue of shares with multiple voting rights post-listing. Existing companies would not be permitted to convert to a dual class share structure as their shareholders did not invest with knowledge of the risks associated with such structures;

c. Automatic conversion of shares with multiple voting rights to ordinary shares upon the sale or transfer of multiple vote shares (unless to permitted holders) or if the owner of such shares ceases to assume a management role in the company. Alternatively, it is also considered that a 'sunset clause' be imposed for the automatic conversion of multiple vote shares to ordinary shares at a prescribed future date after listing.

To minimise expropriation risks, the LAC recommends the SGX to enhance the independence element in companies by;

a. Mandatorily requiring the board, nominating committee, remuneration committee and audit committee of the company to comply with the Code of Corporate Governance with respect to the recommendations on board compositions and independent directors instead of a comply-or-explain basis;

b. The appointment of independent directors of companies with dual class share structures be subject to certain restrictions (or enhanced measures) such as limiting multiple vote shares to one vote per share.

To mitigate the risks of listing poor quality companies with dual class share structures, the SGX has proposed several measures, including:

a. The one share one vote structure will remain as the default position of all new listings and dual class share structures may only be permitted for listing if there is 'compelling reason' to adopt such a structure;

b. Admission of companies based on a holistic assessment by taking into account of the listing applicant's industry, size, operating track record and raising of funds from sophisticated investors. In addition, the SGX is proposing a minimum market capitalization of $500 million to ensure that is sufficient investor demand to justify accepting the potential risks of a dual class share structure;

c. Referral of listing applications of companies with dual class share structures to the LAC provided that SGX had first assessed the listing applicant as being suitable for listing.

To increase investors' awareness of shareholder rights by:

a. Providing prominent and clear disclosure of shareholder rights in prospectuses and complying with the safeguards prescribed in the Companies Act;

b. Issuers should also be required to disclose the holders of multiple vote shares, regardless of shareholdings, both during listing and on a continuing basis in its annual report;

c. More investor education initiatives.

Conclusion

It was the bold, innovative and pragmatic mindset of our leaders that transformed Singapore from an unknown fishing village to one of the major financial hubs in Asia. Instead being conservative, this move to allow companies with dual class share structures to list in Singapore will be a progressive step forward to keep pace with global markets.

The question is certainly a matter of when and how, and not if, Singapore would embrace this change. While it remains to be seen what form the regulatory framework would eventually take, the balance between flexibility of our capital market structures and corporate transparency will be a delicate one to manage. It will also be important to remain mindful of local characteristics including our legal or business environment and institutional differences with other jurisdictions.

About SLW Commentaries

SLW Commentaries are short reviews or commentaries of the latest Singapore Supreme Court judgments, taking an analytical and "big picture" approach on legal developments. Although consisting primarily of commentaries on Supreme Court judgments, SLW Commentaries also include well-written articles on recent legislative changes. Interested contributors may write to SLW for more information.