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KepCorp offer: Shift in vested powers between board, shareholders?

By Mak Yuen Teen

IN the letter "Shareholder nod not needed in Keppel Corp bid: SGX" (BT, Jan 31), Singapore Exchange clarified that it has not granted any rule exemption for Keppel Corporation Limited (KCL) to acquire the shares in Keppel Land Limited (KLL) that it does not already own.

In KCL's offer announcement, "Voluntary Conditional Cash Offer for Keppel Land Limited" dated Jan 23, para 6.2 states: "The SGX-ST has advised KCL that the requirement for the Offer to be approved by the shareholders of KCL under Rule 1014(2) of the Listing Manual is not applicable subject to the provision of an opinion from the board of directors of KCL (KCL Board) that there will be no material change in the risk profile of KCL arising from the Offer and the basis for their opinion, which opinion should be disclosed in this Announcement."

In its letter, SGX pointed to Practice Note 10.1 (PN 10.1) and said that as the acquisition does not change the risk profile or the main business of Keppel Corp, it does not need shareholder approval.

Para 1.1 of PN 10.1 states: "This Practice Note sets out the circumstances under which the Exchange may grant a waiver of the requirement for shareholder approval of any major transactions."

Para 1.2 states that PN 10.1 sets out the general principles only and the Exchange "invites" issuers to consult the Exchange on a particular transaction "if it wants certainty with respect to the application of the rules". Therefore, any waiver is not automatic and requires the Exchange to grant it.

Importantly, para 3.2.2 states: "However, should the acquisition change the risk profile of the issuer, shareholders should have an opportunity to have their say on the proposed acquisition. This is so notwithstanding that the acquisition will not change the main business of the issuer."

Therefore, SGX recognises that an acquisition within the main business may nevertheless change the risk profile of the issuer.

WISDOM OF WAIVER

The crux of the matter is whether SGX should have granted the waiver and whether there is a need to review the listing rules on shareholder approval for major transactions in light of the KCL buyout of KLL.

While it is true that the transaction appears to meet most of the conditions for a waiver set out in PN 10.1, including an opinion from the board that the acquisition does not change the risk profile of KCL, para 3.2.3 of PN 10.1 states that one of the factors that the Exchange will have regard to is whether an acquisition "will have a significant adverse impact on the issuer's earnings, working capital and gearing".

Based on the FY2014 pro forma numbers provided by KCL, the transaction will increase KCL's debt (debt ratio) from S$1.647 billion (0.11) to S$4.734 billion (0.41) while the profit contribution from property will increase from 26 per cent to 35 per cent. According to reuters.com, KCL has a beta (a measure of systematic risk) of 1.36 while KLL has a beta of 1.97. Is it really true that the transaction will not change the risk profile of KCL?

Rule 1001 in the Listing Manual states that in applying the rules for acquisitions and realisations, "it does not matter whether the consideration paid or received is cash, shares, other securities, other assets, or any combination of these". This is sensible because we do not want to create situations where issuers can get around shareholder approval requirements through "creative" financing.

In the well-known hostile takeover of UK-listed Cadbury by US-listed Kraft in 2010, Warren Buffett lamented that even though he was the largest shareholder of Kraft, he had no opportunity to vote on such a major transaction. This is because US listing rules would only require shareholder approval if more than 20 per cent of new shares are to be issued. By all accounts, the board of Kraft pulled out all the stops to avoid triggering shareholder approval requirements, including selling off profitable assets to finance the takeover with more cash.

METHOD OF FINANCING

Although the intent of rule 1001 is laudable, the granting of the waiver in the KCL case suggests that the method of financing an acquisition may affect whether shareholders have a say.

Let us assume that KCL finances the acquisition with new shares. If it offers new shares to KLL shareholders, such a non-pro rata issue of shares would have exceeded the limit of 5 per cent approved by shareholders in its annual general mandate. It would need to get shareholder approval again.

If it had decided to do so through a rights issue to all existing shareholders, it could have done so through the 50 per cent limit approved in the general mandate without needing further shareholder approval – but it would have needed shareholders to support the rights issue.

The listing rules in markets such as the United Kingdom and Hong Kong also require shareholder approval for major transactions. However, having reviewed those rules and consulted sources familiar with them, it does not appear that those markets have provisions for waiver of shareholder approval based on whether a transaction affects the risk profile of the issuer. One could argue that a major transaction would almost inevitably have a significant impact on the risk profile of an issuer, even if it is in the main business of the issuer.

At the heart of the issue of shareholder approval for major transactions is an appropriate balance of power between shareholders and the board of directors. In the US, the rules vest considerable power to the board of directors, leading to concerns about weak shareholder rights and lack of board accountability. In Singapore, like in many other countries, we have developed our rules to provide a better balance between the powers of shareholders and the board of directors.

By allowing issuers to undertake major transactions without shareholder approval based on the subjective assessment of boards of directors as to whether such transactions affect "risk profile", we are in effect vesting more power to the board of directors, thereby altering the balance of power between shareholders and the board of directors. Any shift towards vesting more powers on the board of directors for undertaking major transactions, including acquisitions, without shareholder approval should be carefully considered.

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