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SHAREHOLDER DISPUTES

Oppression, Buy-Out Orders, Share/Business Valuation

INTRODUCTION

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In this article, WMH Law Corporation *in collaboration* with the Berkley Research Group explores both the legal and technical aspects of shareholder oppression claims and business/share valuations.

WMH Law Corporation is a boutique litigation and arbitration firm. The firm and its lawyers have consistently been recognized as one of the leading boutique law firms in South East Asia.

Berkeley Research Group, LLC (BRG) is a global consulting firm that helps leading organizations advance in three key areas: disputes and investigations, corporate finance, and performance improvement and advisory

A Statutory Remedy

Section 216 of the Companies Act (Cap 50) ("the Act") provides an avenue for a minority shareholder who has been "suffering" at the hands of the controlling majority to seek redress.

Such specific remedies available to a "suffering" minority shareholder are listed at Section 216(2) of the Act, including; to compel a share buy-out, provide that the company be wound up, etc.

Who May Apply for Relief?

A shareholder with less than 50% shareholding in the company is naturally understood to be a "minority" shareholder entitled to file a minority oppression lawsuit.

However, the Singapore Court of Appeal clarified in **Ng Kek Wee v Sim City Technology Ltd [2014] 4 SLR 723** that majority shareholders are not precluded from applying under Section 216.

The Court of Appeal explained that "the touchstone is not whether the claimant is a minority shareholder of the company in question, but whether he lacks the power to stop the allegedly oppressive acts. Section 216(1) of the Companies Act states only that "any member…of a company" may bring an action for relief under that provision; there is no further requirement that only members who are minority shareholders are so entitled."

However, the Court of Appeal also cautioned that "It would be contrary to the purpose and intent of s 216 of the Companies Act to permit a shareholder to seek relief where he possesses the power to exercise self-help by taking control of the company and bringing to an end the prejudicial state of affairs". It is always a question of fact whether in a particular case a shareholder claiming relief ought to be considered to lack control over the affairs of the company.

What Constitutes "Oppressive" / "Unfair" Conduct?

Section 216 provides a remedy for a wrong suffered in the shareholder's personal capacity. The individual shareholder sues in his own right to protect his interests as a shareholder of the company. Of course, the conduct complained of must relate to the affairs of the company.

Whilst the local Courts used to rely on four different tests to establish "oppression"; i.e. (1) oppression, (2) disregard of interests, (3) unfair discrimination and (4) prejudice, **Lim Kok Wah and others v Lim Boh Yong and others and other matters [2015] 5 SLR 307** has explained that "There is … little utility in reading the four limbs disjunctively and attempting to draw a distinction between each limb."

The litmus test of "commercial unfairness" involves a consideration of whether there has been a "visible departure from the standards of fair dealing and a violation of the conditions of fair play which a shareholder is entitled to expect".

Remedies for a Minority Shareholder

In deciding what relief to grant to an aggrieved minority shareholder, the Court exercises its discretion "with a view to bringing to an end or remedying the matters complained of".

Section 216(2) of the Act provides a list of such possible remedies:-

a) direct or prohibit any act or cancel or vary any transaction or resolution;

b) regulate the conduct of the affairs of the company in future;

c) authorise civil proceedings to be brought in the name of or on behalf of the company by such person or persons and on such terms as the Court may direct;

d) provide for the purchase of the shares or debentures of the company by other members or holders of debentures of the company or by the company itself;

e) in the case of a purchase of shares by the company provide for a reduction accordingly of the company's capital; or

f) provide that the company be wound up.

Buy-Out Order

Generally, in deciding what relief to grant to an aggrieved minority shareholder, the Court exercises its discretion "with a view to bringing to an end or remedying the matters complained of".

A buy-out order is often regarded as the corporate equivalent of a divorce and, arguably, the most practical option to remedy the "unfairness" of a minority shareholder who has been "suffering" at the hands of the controlling majority.

The High Court's observations in **Leong Chee Kin (on behalf of himself and as a minority shareholder of Ideal Design Studio Pte Ltd) v Ideal Design Studio Pte Ltd and others [2017] SGHC 192** in deciding to grant a buy-out order provides a glimpse into the Court's analysis when dealing with this particular remedy:-

"94 ... In this case, it is patent that the parties' relationship has broken down irretrievably such that they can no longer hold shares in the same company. The defendants no longer wish to have the plaintiff as a shareholder or a director of Ideal Design Studio. That is why they put pressure on him to sell his shares to them and why they removed him as a director when he refused ... . By the same token, the plaintiff no longer wishes to be a shareholder of Ideal Design Studio. That is why he has commenced these proceedings asking, amongst other things, for the defendants to be ordered to buy his shares. Therefore, the most appropriate remedy is to have the defendants purchase the plaintiff's shareholding in Ideal Design Studio."

When the Court grapples with the question of how the aggrieved shareholder's shares should be valued, "[I]t will usually be a matter of expert evidence which basis of valuation is the more appropriate one. Decided cases in this context offer only limited guidance, since cases turn on their facts and the expert evidence which happens to be adduced by the parties" (Robin Hollington Q.C., Hollington on Shareholders' Rights (Sweet & Maxwell, 7th Ed, 2013).

Valuation approaches

The International Valuation Standards (IVS) define three general valuation approaches, namely market, income, and cost approaches. Each of those approaches has its pros and cons, so the applicability and relevance of each approach may vary from case to case.

The **market approach** provides an indication of value by comparing the asset (e.g. shares and/or business) with identical or comparable assets for which price information is available. This approach typically involves the following steps:

a) identify and select comparables;

b)calculate valuation multiples of selected comparables, e.g. multiples of value to a financial performance metric (e.g. EBITDA); and

c) apply the comparable multiples to the relevant metric of the subject asset.

When it comes to the selection of comparables, one may consider the following:

a) historic transactions in the subject asset itself;

b) publicly traded comparable assets (e.g. shares of comparable public companies); and

c) historic transactions in comparable assets (e.g. acquisitions of shares in private companies).

All else being equal, the suitability of the market approach increases with homogeneity and liquidity of comparable assets. However, in a shareholder dispute context, comparable companies are rarely identical to the business in question. Therefore, a valuer may consider the following differences between the subject business and comparables, before concluding on the appropriate valuation multiple to be applied:

a) expected growth (e.g. in cash flows);

b) nature of the business and individual business segments;

c) geography of operations;

d) profitability; and

e) stage of development.

The **income approach** provides an indication of value by converting future cash flows that the asset is expected to generate to a single current value.

Generally, all valuation methods under the income approach are based on discounting future cash flows to present value, i.e. they are variations of the discounted cash flow method (DCF). The key steps involved in the DCF valuation of a business are as follows:

a) prepare a forecast of cash flows that the business is expected to generate over an explicit period of time;

b) if appropriate, consider the cash flow assumptions after the explicit period, e.g. a constant perpetual growth rate;

c) determine the appropriate discount rate to be applied to future cash flows. The concept behind discounting future cash flows is that (i) $1 today is worth more than $1 tomorrow (i.e. time value of money); (ii) risk-free $1 is worth more than uncertain $1; and

d) convert the future cash flows into their net present value as at the valuation date.

Although the DCF method allows one to explicitly incorporate all cash flows assumptions into the calculation (as opposed to making implicit assumptions by using market multiples), the relevance of this method depends on the availability and reliability of the cash flow forecast for the business in question. In shareholder disputes, particularly over smaller businesses, forecasts may not be necessarily prepared by management or any other parties.

The **cost approach** provides an indication of value using the economic principle that a buyer will pay no more for an asset than the cost to obtain an equivalent asset. In other words, the premise of the cost approach is that the cost of replacing an asset is a reasonable measure of the asset's economic benefit, which may not necessarily hold.

In a shareholder dispute context, the cost approach may be used by applying the net asset method. Under the net asset method, the value of the shares equals the value from an orderly realisation of the company's assets on a piecemeal basis, subject to discharging the company's liabilities. The net asset method is not generally appropriate for going concern businesses that are expected to generate future profit, albeit this method may provide a minimum value reference for such companies.

Case-specific valuation considerations

The relevance and application of the above-mentioned valuation approaches and methods is dependent on the circumstances of a dispute. In particular, considerations as to the nature of the business and stage of development may be important.

In valuing natural resource type businesses, it is common to see the DCF method being applied to calculate the present value of cash flows over the expected period of production (e.g. until resources are depleted). As to the market approach, such companies may also be valued by reference to multiples of resources (e.g. value per pound of reserves of a mining asset).

For power and utility sector companies, alongside DCF one may also use value per capacity multiples, e.g. value per MW for a power plant. Industry-specific multiples are also applied in the telecommunications and technology sectors, e.g. value per mobile network customer or online user.

In contrast to the above-mentioned sectors, DCF is less frequently applied in valuing financial services entities, e.g. banks and insurance companies. These companies are valued primarily using the market approach, in particular by applying multiples of price to either equity book value or net profit.

The company's stage of development is also an important consideration in deciding on the valuation method. For example, an early-stage or start-up company may not yet generate any profit and, as a result, value-to-profit multiples may not be applicable. If an early-stage business is forecast to experience substantial growth before becoming profitable in the future, this may prompt the use of DCF as the most relevant valuation method, given that one can implicitly account for cash flow growth assumptions in the DCF model.

Contrary to the early-stage / start-up business, an established company with a stable profit and/or cash flow is generally more suitable for the application of the market approach, all else being equal. However, this is subject to identifying comparable companies with sufficiently similar growth and risk profile to that of the subject business.

As to valuing loss-making companies, in addition to DCF, one may consider applying revenue multiples, subject to making adjustments to reflect the difference between the multiples of comparables (e.g. if they are profitable) and the loss-making business in question.

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