DEEMED WAIVER OF PRE-EMPTION RIGHTS: GETTING IT RIGHT

A "pre-emption right", in company law terms, is a contractual right given to existing company members to purchase shares before they can be offered to a non-member. Providing members with pre-emption rights is a common way for private companies to restrict their right to transfer shares, which is mandatory under the Companies Act (Cap 50) of Singapore. It is also used as a tool to prevent share dilution of existing shareholders, when a company issues new shares.

How Waivers Work

In the event that a company wishes to issue new shares or transfer existing shares with pre-emption rights, it must, unless otherwise specified in its Constitution, offer the shares to existing members first through notice, specifying the number of shares offered and the deadline for accepting the offer. Sometimes, a company may find itself in situation where it needs to raise funds quickly by issuing shares. One way to speed up the process is by obtaining unanimous written consent from existing members to waive their pre-emption rights. This is usually done by sending a detailed document specifying the background and request for such waivers to the existing members. The members have to indicate their consent or refusal, as the case may be, to waive such rights. The members then have to return the document to the company.

Unfortunately, some members may choose not to respond to the waiver document, making it neither an outright consent nor a refusal. Well-drafted Shareholders' Agreements and Constitutions should ideally include mechanisms for the waiver process, including how existing members can indicate consent or refusal, and whether silence or inaction from existing members after a certain period of time can constitute a "deemed waiver". In the absence of such provisions, deeming the inaction of existing members after a period of time (especially a date specified on the waiver document) as deemed consent is possible, albeit unlikely and not very useful on its own given the amount of time needed.

What is needed for a "waiver"

The term "waiver", in its purest sense, it simply means the abandonment of rights of a person by communicating to another that the latter no longer has to perform its future obligations to the first person. All forms of waiver require two elements:

(1) An unequivocal communication, be it through words or conduct, to forgo its rights in relation to such waiver;
(2) The communication must be made when the person waiving is aware of the facts that gave rise to the rights that are being foregone, of the actual right, and the connection between the two.

Silence or Inaction Can (Rarely) Amount to an Unequivocal Communication of Waiver

The general principle is that silence, delay or a failure to act cannot, absent unusual facts or other indicators, form an unequivocal representation such that the existing member will be held to have waived it rights. This is because we can only take a conduct to be unequivocal only when it is capable of

one construction alone, with the burden of proof falling upon the party who alleges that a waiver has been made. In this case, inaction on the part of any existing member can not only be construed as a waiver of their pre-emption rights, but also as a delay in making a decision, or even a refusal to forgo their rights.

It could be helpful to examine whether the second element is fulfilled, because it is possible to prove unequivocal representation from an existing member's displayed knowledge about its right to choose, along with its inaction for an unreasonable length of time. This can be derived from evidence such as clear prior correspondences or negotiations with the existing member discussing its rights and the relevant facts.

What is a Reasonable Length of Time?

The reasonable time needed for a decision to be made is a question of fact depending on all the circumstances in each case, and is often described as a more flexible time range rather than a precise period. The court takes into account a non-exhaustive list of factors such as resulting prejudice to the company or an innocent party, disruption to business efficacy, and whether the inaction is consistent with an unequivocal representation to forgo rights. However, we need to bear in mind that specifying the time on the waiver document is a unilateral stipulation of time for the existing member to make an arguably more self-prejudicial decision of waiving its rights, compared to say, a decision to accept an offer of sale. The time requirements for deeming a waiver are thus likely to be more stringent in favor of the waiving party.

Legislation and regulations governing other procedures for pre-emption rights may provide some guidance on what can be considered a reasonable length of time before inaction can be deemed as consent to waiver. Although there are no statutory provisions or regulations in Singapore that govern the expiry period after which the offer of shares made to existing members lapses, existing members may challenge the reasonableness of the expiry period in court (through the provisions that deal with "minority oppression", for example). The UK Companies Act, on the other hand, stipulates that existing members with pre-emption rights must be allowed at least 21 days to take up the offer. Even though Singapore has chosen not to include this provision in its recently amended Companies Act, it's possible that a significant deviation from 21 days could be taken to be unreasonable.

Shareholders of the company may also vote to amend provisions relating to pre-emption rights and/or the relevant procedures by passing a special resolution with a 75% majority, based on section 184 of the Companies Act. For private companies, written notice must be given to the shareholders at least 14 days before the meeting, while for public companies it is at least 21 days.

Given that a waiver of pre-emption rights is essentially the abandonment of an existing member's rights without the need for consideration (i.e. receiving benefits in return), and one that requires unanimous consent of all existing members at that, the notice requirement should be equally as long, if not longer than the 14 or 21 days needed for passing special resolutions, which only require a 75% majority.

Other Alternatives

Another alternative could be to pass a special resolution via written means, instead of calling for a general meeting, as written resolutions do not require a minimum period of notice. This can only be done if at least 75% of the shareholders (for a special resolution) are cooperative and sign the written resolutions promptly. The danger, however, is that an uncooperative member with more than 5% of voting rights may call for a general meeting under section 184D of the Companies Act, which would mean having to wait for another 14 or 21 days, as the case may be.

A more viable and convenient option would be to draft a document that includes both the option for waiver and the offer to purchase shares, with a reasonable deadline for acceptance specified, after which inaction would be deemed non-acceptance. In this manner, the existing member may effectively be forced to react by providing a conclusive reply, one way or the other. Having both the waiver and offer provisions in the same document allows a company to enjoy both the potential reward of speeding up share issuance significantly through waiver and also to reduce its risk of having to wait indeterminately for a response from an existing member through an offer.

Conclusion

Deeming silence or inaction as consent to waiver can be mildly defensible at best. Even with unusual circumstances present, a company would still have to wait for two or three weeks for inaction to plausibly be deemed a waiver. On the other hand, since Singapore company law does not fix a minimum amount of time for existing members to consider offers of shares from the company – a possible indicator that Singapore values minority shareholder protection without detrimentally eroding the power of the majority and impeding business efficacy. To prevent the sale of shares to non-members from being rendered void due to a breach of provisions relating to pre-emption rights in the Constitution, Singapore companies should refrain from relying on deemed waivers alone, and utilize other mechanisms outlined above to avoid potentially damaging shareholder disputes.

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