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Reits should be careful with trust schemes of arrangement

Given added scrutiny of such schemes, Reits should consider if it is most appropriate method to achieve their objectives

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REAL estate investment trusts (Reits) in Singapore may have to be more careful when they undertake a trust scheme of arrangement in future as such schemes will likely draw more scrutiny, say corporate lawyers.

This follows the recent privatisation of Soilbuild Business Space Reit (Soilbuild Reit) in March, where the Singapore High Court had raised concerns over the use of the one-proxy rule and the legal basis for a Reit trust scheme to be carried out.

While the privatisation went through, the High Court said during the hearing that the one-proxy rule has the "potential to cause prejudice".

A Soilbuild Reit unitholder had earlier opposed the trust scheme sanction application on the grounds that the one-proxy rule, which allows for the appointment of only one proxy per unitholder, should not have been used for the trust scheme meeting. The court hearing was thus adjourned to allow time for the Reit manager to compile and provide further information to the court.

A partner of a major law firm, who declined to be named, drew similarities between the Soilbuild Reit case and an earlier case in January this year relating to shipping company Pacific International Lines (PIL).

The court had then directed that the voting instructions received by nominee holders of bonds issued by PIL be recorded by the scheme manager for the court's consideration.

In light of the doubts raised by the court during the Soilbuild Reit hearing, the partner said that "Reits seeking to undertake a scheme of arrangement should carefully consider whether the process and procedures it intends to adopt are fair, and how they will affect the question of whether the voting results obtained at the scheme meeting are an accurate reflection of the level of support for the scheme for final court sanction purposes".

Similarly, lawyers at Rajah & Tann Asia noted in an April commentary that while the one-proxy rule is an established industry practice, "an applicant for a trust scheme may need to consider taking steps to satisfy the court that its application of the proxy regime did not disenfranchise minority unitholders".

During the case, the High Court had also taken "great interest in a separate question as to where the legal basis of a Reit trust scheme can be found", according to another commentary by INC Law, which represented the dissenting unitholder.

Section 210 of the Companies Act covers the premise for schemes of arrangement within companies, but there is no such similar statute for Reit trust schemes. Instead, reference to a Reit trust scheme can be found in Singapore's code on takeovers and mergers, though it is neither primary nor subsidiary legislation, it noted.

The High Court had thus added that it was "mindful of the fact that (it had) doubts about the basis on which the rights of unitholders can be expropriated, even under a trust scheme".

Jaryl Lim and Lim Ming Yi, associate and associate director at INC Law, also raised a separate question as to whether a trust scheme can be "legitimately adopted in the context of a Reit" which deals with real estate property and property rights, noting: "Should dissenting unitholders have their property rights seized just because a majority of unitholders say so?

"This calls into question an even more fundamental legal issue as to whether a Reit should be considered a corporate or a trust structure, because that in turn determines whether company law – where the majority rule is often the default rule – should apply, or whether trust law should apply instead."

At present, there is existing legislation for the acquisition of Reits under section 295A of the Securities and Futures Act, which requires approval of investors holding 90 per cent of the Reit's units.

Thus, the duo at INC Law noted that Reit clients looking to do a takeover should "seriously consider whether a trust scheme is the most appropriate method to achieve their objective".

"One can no longer rule out the possibility of a formal challenge in court involving the legitimacy of a trust scheme, in which case a Reit client should be prepared to defend such an objection and show why a trust scheme may be adopted in lieu of an acquisition under section 295A," they added.

In Singapore, the one-proxy rule is typically deployed as a tool to satisfy the "headcount test".

The local regulatory regime requires a scheme of arrangement to cross two thresholds. It must be approved by creditors or shareholders representing three-fourths in value of those voting at a scheme meeting; it must also be approved by a simple majority, in number, of the scheme company's creditors or shareholders present or voting at the meeting.

This second threshold is commonly known as the headcount test.

In order to facilitate calculations for the test, custodian banks or nominee companies that hold shares on behalf of multiple shareholders are considered as a single shareholder and are usually only allowed to vote one way.

However, the Singapore court has the power to waive the headcount test, under a revision to the Companies Act in 2016.

Rajah & Tann's lawyers therefore noted that "an applicant may also need to consider whether to apply for the court to direct a different regime of proxy voting for the company scheme (or) trust scheme meeting".

For instance, the use of multiple proxies could be considered instead, which would allow for the votes at such scheme meetings "to be counted on a 'see-through' basis, to allow for clients of the relevant intermediaries to each submit their votes directly as if they were direct unitholders", they said in their commentary.

The Soilbuild Reit case is not the first instance of the one-proxy rule coming under fire.

During the failed merger of Sabana Reit and ESR Reit last year, activist fund managers Quarz Capital Management and Black Crane Capital had similarly raised concerns over potential "voting irregularities" as a result of Sabana Reit's one-proxy rule.

Since then, the market has become more aware of the pitfalls of the one-proxy rule.

When jewellery group Aspial Corp took its subsidiary World Class Global (WCG) private, it provided clear information on how votes by share custodians would be treated.

In a May announcement, WCG noted that relevant intermediaries, such as that of nominees, "need not cast all the votes it uses in the same way".

WCG said if an intermediary cast more votes for the scheme than against it, that intermediary would have been considered as casting one vote in favour of the scheme, and vice versa.

If the intermediary cast equal votes for and against the scheme, WCG would have treated it as casting one vote for and one vote against the scheme.

Of course, such clarity does not amount to fairness to investors. On the contrary, it merely highlights everything that is wrong with current practice.

INC Law's Mr Jaryl Lim and Mr Lim Ming Yi said that it would "be of great benefit to Reit clients and lawyers alike if the relevant authorities could weigh in on the legal basis of the use of a trust scheme and one-proxy rule in the context of a Reit".

"This will provide greater clarity as to the possible legal mechanisms for the take-overs or mergers of Reits in the future."