MINORITY SHAREHOLDERS WATCH GROUP
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Can PLCs evade two-tier voting?

by **Devanesan Evanson**

Directors who wish to continue as independent directors beyond their 12th year tenure would be subject to a two-tier voting by the company

The Malaysian Code on Corporate Governance (MCCG) advocates the practice of seeking annual shareholders' approval through a two-tier voting process for independent directors who wish to be re-elected as independent directors after their 12th year tenure (Practice 4.2).

A two-tier voting is premised on the reality that over time, there is attrition on the independence of independent directors. No one can say when exactly an independent director crosses the boundaries of independence and becomes dependent.

To make pragmatic sense of this reality, many regulators all over the world have introduced quantitative measures for such boundaries. One such measure, in Malaysia, is that directors who wish to continue as independent directors beyond their 12th year tenure would be subject to a two-tier voting by the company.

Some public-listed companies (PLCs) have departed from the application of a two-tier voting process as stated in Practice 4.2. A common reason given by these PLCs is that such voting is illegal as it offends the majority-rule principle.

One PLC has explained its departure in its Corporate Governance Report in a detailed and legalistic manner. The PLC, regardless of whether its explanation has merits or not, should be commended for its detailed explanation, along with judicial case and judgement references, instead of adopting a boiler-plate explanation of a departure from a practice in the MCCG.

The PLC starts off by stating that the board, through its Nomination, Remuneration and Scheme Committee (NRSC), assesses independent directors annually to ascertain if they display a strong element of objectivity, both in appearance ("perceived independence") as well as of mind ("independence in thought and action").

It should be noted that two of their independent non-executive directors have each served the board for a cumulative period exceeding 12 years.

The board stated that it was guided by the legal opinion that the two-tier voting process is not consistent with the principle of majority rule as affirmed by Siti Norma Yaakob J in ***Jaya Medical Consultants Sdn Bhd v Island & Peninsular Bhd & Ors*** **(1994) 1 MLJ 520** at p540 and the fundamental proposition that "all shareholders are entitled to equal treatment unless and to the extent that their rights in this respect are modified by the contract under which they hold their shares" (***Collaroy Co v Giffard*** **(1928) Ch 144** at 158).

The board said there was only one class of ordinary shares in the company and the rights of the holders, including the right to vote, shall rank *pari passu*. A resolution which was passed by a majority of shareholders must be regarded as having validly passed as a matter of law, irrespective of whether a majority of both large shareholders (as defined in the MCCG) (see sidebar) and other shareholders had voted in favour of such a resolution as required under the MCCG.

The company concluded its explanation of its departure from the MCCG by stating that the board (except for the two directors who had exceeded the 12-year tenure) had agreed that a single-tier shareholders approval be sought for retention of the independent directors at their forthcoming annual general meeting (AGM). This process would allow shareholders to be sounding boards to provide feedback to the board on the independent directors who have served beyond the 12th year.

The company stated that the NRSC had reviewed and recommended to the board for the two directors to continue to act as independent directors of the company. The NRSC was of the view that the independent directors had carried out their responsibilities in good faith in the best interest of the company and have safeguarded the interests of the minority shareholders of the company.

The company stated that its board recognised that its current composition had the right mix of skills, objectivity and in-depth experience required for the company's businesses.

The board believed that there were significant advantages to be gained by promoting continuity as the two directors had proven to have good understanding of the company's businesses, enabling them to provide independent views and judgement in the best interest of the company.

Based on the assessment, both the NRSC and the board had concluded that the two directors, who had served more than 12 years, remain objective and independent in expressing their views and in their participation in deliberations and decision making of the board and board committees. In this respect, the board recommended that the two directors continue to serve as independent directors subject to shareholders' approval at the forthcoming AGM of the company.

The company has politely, along with its rationale, stated that it will not adopt a two-tier voting.

Securities Commission's views

The Securities Commission (SC), in its Frequently Asked Questions section on the MCCG (revised on July 5, 2018), stated that a two-tier voting should be tabled to shareholders at general meetings held after Jan 1, 2018.

The SC said the two-tier voting process does not contradict any provision under the Companies Act 2016 (particularly Section 291) or the listing requirements.

The SC stated that Section 291 defines the application of ordinary resolution of members or a class of members of a company, and that an ordinary resolution is passed by a simple majority of more than half of such members. It does not specifically deal with the appointment or re-appointment of directors.

In relation to Section 202 of the Companies Act, the SC stated that the appointment of any subsequent director may be settled by an ordinary resolution. The SC said in Section 202, the term used is "may" and that it is well settled that the use of that word in a statutory provision would not by itself show that the provision is directory in nature. Therefore, companies are allowed to determine the manner in which shareholders will exercise their rights in relation to the appointment or re-appointment of directors.

MSWG queries the board

Minority Shareholders Watch Group (MSWG), in its questions addressed to the board for its forthcoming AGM, pointed out to the company that it has departed from Practice 4.2 of the MCCG as the board does not intend to seek shareholders' approval through a two-tier voting process for the retention of the independent directors who have served more than 12 years.

MSWG also pointed out to the company the SC's clarification as per their Frequently Asked Questions.

The company replied that it noted the SC's clarification, especially the SC's statement – "Therefore, companies are allowed to determine the manner in which shareholders will exercise their rights in relation to the appointment or re-appointment of directors" – and that under such circumstances, the board has decided that a single-tier shareholders' approval should be sought for retention of the long-serving independent directors (and the justification is as provided in their Corporate Governance Report).

The company concludes its reply to MSWG by stating that its adopted process will allow shareholders to be sounding boards to provide feedback to the board on the independent directors who have served beyond the 12th year. As a form of measure, the board will take steps to review the board composition and apply the MCCG practices by taking into the account the environment, size and complexity, and nature of risks and challenges faced.

Again, the company has politely, along with its rationale, stated that it will not adopt the two-tier voting process.

Levelling the playing field

The SC had stated clearly that two-tier voting should be tabled to shareholders at general meetings held after Jan 1, 2018. As such, there cannot be discretion as to whether to apply Practice 4.2 of the MCCG on the two-tier voting process. There cannot be two sets of practices in the capital market due to interpretational discretion.

MSWG is of the view that the two-tier voting process for independent directors, who wish to continue as independent directors beyond their 12th year tenure, is a meaningful empowering tool for minority shareholders to have a meaningful say in these directors' re-election.

In fact, MSWG is of the view that Practice 4.2 should be a listing requirement. FocusM

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Two-tier voting

UNDER the two-tier voting process, shareholders' votes will be cast in the following manner at the same shareholders meeting:

- Tier 1: Only the large shareholder of the company votes.
- Tier 2: Shareholders other than the large shareholders vote.

For the purposes of Practice 4.2, a large shareholder means a person who:

- is entitled to exercise, or control the exercise of, not less than 33% of the voting shares in the company;
- is the largest shareholder of voting shares in the company;
- has the power to appoint or cause to be appointed a majority of the directors of the company; or
- has the power to make, or cause to be made, decisions in respect of the business or administration of the company, and to give effect to such decisions or cause them to be given effect to.

The decision for the above resolution is determined based on the vote of Tier 1 and a simple majority of Tier 2.

If there is more than one large shareholder, a simple majority of votes determines the outcome of the Tier 1 vote.

The resolution is deemed successful if both Tier 1 and Tier 2 votes support the resolution.

However, the resolution is deemed to be defeated where the vote between the two tiers differs or where Tier 1 voter(s) abstained from voting.