

# The Introduction of the Statutory Merger in South African Corporate Law: Majority Rule Offset by the Appraisal Right (Part 2)\*

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## 7 Reverse Triangular Merger

The reverse triangular merger procedure is similar in structure to the triangular merger, with the would-be acquirer, Company H, forming a wholly-owned subsidiary, Company S, to act as the acquisition vehicle for the merger with the target, Company T. The essential difference between the triangular merger and the reverse triangular merger structure is that in the former, Company T merges into Company S with Company S remaining in existence as the surviving company, while in the latter it is Company T that is the surviving company. Thus, paradoxically, the *target* company is the *surviving* company in a reverse triangular merger and the *acquiring* company *disappears*.

The end result of a reverse triangular merger is, first, that Company T becomes a wholly-owned subsidiary of Company H; secondly, that Company S, which is a newly formed company for the purposes of the merger, disappears under and pursuant to the merger; and thirdly that the former shareholders in Company T or the surviving company give up their shares in return for the merger consideration, usually in cash or shares in Company H. This is a rather illusory and artificial procedure, not least because the merger consideration is, in effect, paid to the shareholders of the *surviving* company, Company T, and not, as in the usual course, to the shareholders of the disappearing company in consideration for their shares in the disappearing company.<sup>167</sup>

The reverse triangular merger is nonetheless permitted by modern merger legislation in America. It serves an important purpose in circumstances where the preservation of Company T's corporate personality is indispensable, for instance, to preserve valuable licences, leases or other contracts that would not survive a merger that results in the disappearance of Company T. This would apply to contracts between Company T and third parties, which by their very nature or by their express terms preclude their automatic transfer by the operation of law to any other company consequent upon a merger.<sup>168</sup>

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<sup>167</sup> See Hamilton op cit note 88 at 630-1; Clark op cit note 16 at 431.

<sup>169</sup> See Pinto & Branson op cit note 11 at 124.

It is submitted that the Companies Bill creates scope for reverse triangular mergers in South African law. Clause 117(2)(c) of the Bill, read with cl 117(2)(d) and (e), makes provision for ‘the shares of *each* amalgamating or merging company’<sup>169</sup> to be converted or exchanged into the merger consideration. The Bill consequently does not restrict the payment of merger consideration only in respect of the shares of the disappearing company, but also allows for the payment of merger consideration for the shares of the surviving company. The target of the merger, whose shareholders receive the merger consideration, can therefore play the role of either the disappearing company under the merger agreement or the surviving company (in a reverse triangular merger). However, whether the courts would find the reverse triangular merger structure to be an artificial or an otherwise objectionable form of transaction, will remain to be seen, although on the face of it and barring a fraudulent or unlawful purpose, there is no reason for it to be condemned as objectionable.

## 8 The Freeze-out Merger

### 8.1 The Purpose of the Freeze-out Merger

A distinction must be drawn between an *arms’ length merger* and a *controlled* or *interested merger*. In an interested merger, the acquiring company in the transaction holds an equity interest in the target company, usually as the majority or controlling shareholder of the latter.<sup>170</sup> The controlling shareholder could initiate a *freeze-out merger* between itself as acquirer and the company as the target, with the purpose of eliminating the equity interests of the minority shareholders in the company. Pursuant to the freeze-out merger, the controlling shareholder remains as the *sole shareholder* in or ‘owner’ (in an economic not a legal sense) of the company, while the former minority shareholders of the company are eliminated or frozen out, usually in return for a cash consideration or other securities or property or shares in the controlling shareholder which the controlling shareholder will issue in its capacity as the acquiring party in the freeze-out merger.<sup>171</sup>

Accordingly, as commonly stated in Delaware case law, the controlling shareholder stands on both sides of a freeze-out transaction, being both the acquiring party as well as the controlling shareholder of the target.<sup>172</sup> This entails a manifest conflict of interest and a risk of oppression of the minority

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<sup>169</sup> My emphasis.

<sup>170</sup> The controlling shareholder need not be the holding company or majority shareholder of the target company, as in certain circumstances even where the controlling shareholder holds less than 50 per cent of the shares in the target company this may be sufficient to exercise control (in the context of a proposed merger), particularly where there are numerous minority shareholders each holding very small numbers of shares.

<sup>171</sup> Pinto & Branson op cit note 11 at 231-2; Clark op cit note 16 at 472.

<sup>172</sup> See, eg, *Weinberger v UOP, Inc* 457 A 2d 701 (SC Del, 1983) at 710; *Kahn v Lynch Communications Sys Inc* 638 A 2d 1110 (SC Del, 1994) and 669 A 2d 79 (SC Del, 1995); and *Kahn v Tremont*, 694 A 2d 422 (SC Del, 1997).

shareholders. Not only is there disparate treatment of the majority and the minority (with the former remaining a shareholder in the target company, while the latter are frozen out of the company), but moreover, since the controlling shareholder stands on both sides of the transaction, it could in principle have the power to determine the type and the amount of consideration that the minority shareholders will receive in return for the forfeiture of their shares.<sup>173</sup> Freeze-out mergers may consequently have a suspect motive. This is particularly so in times of market depression, where the majority shareholder may acquire the control of the company at the expense of the minority shareholders, as occurred so widely in America in the 1960s and 1970s, resulting in much controversy on the issue of freeze-out mergers.<sup>174</sup>

A freeze-out merger may take the form of a *cash-out merger*<sup>175</sup> where the minority shareholders receive cash as consideration for the elimination of their shares. Indeed, the introduction of cash as a permissible merger consideration enhances the appeal and the popularity of the freeze-out merger, as evidenced by the rapid growth of freeze-out mergers in America in the 1960s when cash first became permissible as a merger consideration.<sup>176</sup> A freeze-out merger may also be used to effect a *going private transaction*<sup>177</sup> where the object of the merger is to transform a widely held or public company into a closely held or private company by eliminating the minorities in order to obtain the attendant benefits of converting to a private company, such as less onerous disclosure and reporting requirements and cost savings while at the same time securing all the economic benefits of the target company for the acquirer alone.

Although the policy issues and the potential for oppression of minority shareholders in freeze-out mergers has long been a controversial issue in America and Canada,<sup>178</sup> these controversies have now been settled by retaining the freeze-out merger but supplementing it by various protective measures designed to ensure fairness to minority shareholders. (A full discussion of the policy issues and minority protection measures associated with freeze-out mergers is beyond the scope of this paper.)

The Companies Bill pre-empts some of these policy issues by (seemingly) introducing a firm minority-protection measure in cl 119(8). This provides that voting shares controlled by an acquiring party or a person acting in concert with an acquiring party cannot be voted in respect of a proposed merger.<sup>179</sup>

<sup>173</sup> See Iacono op cit note 120 at 659-60.

<sup>174</sup> See Allen & Kraakman op cit note 4 at 465; Clark op cit note 16 at 472.

<sup>175</sup> See Allen & Kraakman op cit note 4 at 465.

<sup>176</sup> See Pinto & Branson op cit note 11 at 238.

<sup>177</sup> See Hamilton op cit note 88 at 622.

<sup>178</sup> See, eg, V Brudney & M Chirelstein 'A Restatement of Corporate Freeze-outs' (1978) 87 *Yale LJ* 1354 at 1356-74.

<sup>179</sup> Nor can they be included in counting the number of shares voted in support of the resolution: cl 119(8). This clause is discussed further in par 8.2 below.

## 8.2 The Structure, Shareholder Voting and Minority Protection in a Freeze-out Merger

The Companies Bill facilitates freeze-out mergers and permits them to be structured either as a two-party merger or as a triangular merger. Each of these structures will be considered, together with their shareholder-voting requirements and minority-protection measures.

The structure of a two-party freeze-out merger may be described as follows. The target company is merged directly into its controlling shareholder in its capacity as the acquiring company. The minority shareholders invariably receive cash as the consideration for the elimination of their shares in the target company. In this connection, redeemable preference shares, redeemable immediately upon the implementation of the merger, would be a very useful alternative to cash. The shares held by the controlling shareholder in the target company fall within the ambit of cl 117(3) of the Bill<sup>180</sup> as shares held by one merging company in the other merging company. Accordingly the shares of the controlling shareholder/acquiring company in the target company stand to be cancelled, without repayment of capital or a conversion into shares of the acquiring company. The result of the merger is consequently that the controlling shareholder remains as the sole shareholder of the target company, whilst the minority shareholders of the target company are eliminated.

Turning to the shareholder voting by the shareholders of the target company in respect of such a two-party freeze-out merger, it is submitted that cl 119(8) applies in these circumstances. As stated above, this clause provides that the voting shares controlled by an acquiring party or a person acting in concert with an acquiring party are not entitled to be voted on a merger. However, the term ‘acquiring party’ is once again significantly and regrettably undefined, and for this reason it renders the interpretation of this provision open to debate. There is also no comparable provision to be found in any of the leading jurisdictions such as Delaware, Canada, New Zealand, nor in the American Model Business Corporation Act. It is submitted that the object of cl 119(8) is that in an interested merger – where the acquiring party and the target are not at arms’ length due to the control by the *acquiring party* of voting shares in the *target company* – the acquiring party<sup>181</sup> is precluded from voting its shares on the resolution by the target company in respect of the merger. This gives due recognition to, and takes cognisance of, the acquiring party’s conflict of interest, given that it is both the acquirer as well as a shareholder of the acquired company. Absent this provision, the acquiring party, where it holds sufficient shares in the target company, would have the power to abuse its position by having the target company adopt the merger

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<sup>180</sup> See par 5 above.

<sup>181</sup> As well as any other party acting in concert with it. The directors of the acquirer are also presumed to act in concert with the acquirer and will be precluded from voting their shares, if any, in the target company: cl 2(2)(b)(i).

resolution *merely on the strength of its own vote*, in its capacity as a shareholder of the target company.

Clause 119(8) may in effect be regarded as a ‘majority-of-minority-vote’ provision in an interested merger. To put it differently, a vote of the majority of the *minority* (or *other*) shareholders is required where a merger is proposed between the company in which they hold shares and one of the existing shareholders of the company. This provision goes a long way towards protecting the minority shareholders of the target company in an interested merger.

Indeed case law in Delaware<sup>182</sup> leans strongly towards the view that in freeze-out mergers<sup>183</sup> it is both desirable and appropriate for the transaction to be approved not only by the requisite majority of the shareholders of the target company as a whole, but also by a majority of the *minority* shareholders after a full disclosure of the material facts. In Ontario, such a provision is to be found in the Ontario Securities Commission Rules<sup>184</sup> which require that in the event of a freeze-out merger, in addition to the requisite statutory majority vote of shareholders required generally for a merger, a majority of the shareholders *other than* those seeking to effect the transaction must approve of a going private transaction, which effectively also gives the minority shareholders of the target company the right to veto the merger.

The Companies Bill, by contrast, seeks to entrench this minority-protection measure in a conflict-of-interest situation even more firmly than does Delaware or Ontario, namely by embodying it in a statute.

Having discussed the two-party freeze-out merger, it is appropriate to turn to the alternative structure for a freeze-out merger, namely where it takes the form of a triangular merger. This is in fact the more commonly used mechanism in America.<sup>185</sup>

A triangular freeze-out merger is theoretically permissible under the Companies Bill, in view of its inclusion of both cash mergers as well as triangular mergers. A triangular freeze-out merger entails the formation of a wholly-owned subsidiary (Company S) by the controlling shareholder of the target company/would-be acquirer (Company H), which subsidiary functions as the acquisition vehicle in the merger with the target company (Company T). Upon effectuation of the merger of Company T into Company S, the merger consideration payable to the minority shareholders of Company T for their shares usually takes the form of cash or redeemable preference shares in the subsidiary acquisition vehicle which are redeemed immediately. Technically, the merger consideration payable to Company H in its capacity as the controlling shareholder of the target company normally consists of further

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<sup>182</sup> See, eg. *Weinberger v UOP, Inc* supra note 172.

<sup>183</sup> In the context of the entire fairness standard of judicial review.

<sup>184</sup> See the Ontario Securities Commission Insider Bids, Issuer Bids, Business Combinations and Related Party Transactions, OSC Rule 61-501, 27 *OSC Bull* 4493 (7 Mar 2004) in relation to a ‘business combination’ such as a squeeze-out/freeze-out merger by way of amalgamation.

<sup>185</sup> Kenyon-Slade op cit note 9 at 59; Pinto & Branson op cit note 11 at 232; Practical Law Company op cit note 145 at 429.

shares in the subsidiary acquisition vehicle. This mechanism was relied on by the merging parties in the well-known Canadian decision in *Neonex International Ltd v Kolasa*.<sup>186</sup>

It is submitted that the minority-protection measures of cl 119(8) of the Bill would nonetheless apply, and would preclude the controlling shareholder, Company H, from voting on a triangular freeze-out merger in its capacity as a shareholder of the target company, despite the fact that in this merger structure Company H is *not* the *acquiring* party but merely its holding company. On the basis that the acquiring party, that is Company S, is the wholly-owned subsidiary of Company H and that as such Company H ‘act[s] in concert’ with the acquiring party, cl 119(8) would preclude Company H from voting any of its shares in the target company in respect of the merger resolution.<sup>187</sup>

Parallels may be drawn between the majority-of-minority vote requirement in cl 119(8) and the decision in *Re Hellenic & General Trust Ltd*<sup>188</sup> which concerned a going private transaction under a scheme of arrangement in terms of which the minority shareholders of the Hellenic company faced elimination. In effect this involved a freeze-out *scheme of arrangement*. The issue before the Court was whether MIT, a wholly-owned subsidiary of the offeror that held 53 per cent of the common shares in the offeree Hellenic, fell into a voting class separate from the minority shareholders in Hellenic. The Court found that MIT did indeed fall into a separate class. The minority shareholders were thus given a right to vote separately on, and potentially to veto, the freeze-out scheme of arrangement. Similarly, in the context of a freeze-out *merger*, the effect of cl 119(8) of the Bill would be that a shareholder in the position of MIT would be regarded as acting in concert with the acquiring company, and would thus be precluded from voting its shares in the target company in respect of the merger resolution, thereby effectively giving the minority shareholders of the target company a right to veto the freeze-out merger.<sup>189</sup>

Needless to say, the majority-of-minority vote is only a necessary but not a sufficient protection for the minority shareholders in a freeze-out merger. Further effective minority-protection measures are required. Amongst these would be adequate disclosure to the minority shareholders of all material facts relating to the merger (absent which the right to vote on the merger as a

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<sup>186</sup> Supra note 109.

<sup>187</sup> In this regard the Bill provides that persons ‘act in concert’ where they ‘act with a common purpose or under common control’: cl 1; that ‘[t]wo or more persons are presumed to act in concert if they are related or inter-related’ (unless there is sufficient evidence to conclude that they act independently of one another): cl 2(2)(a); and that ‘a juristic person is related to another person if either is a subsidiary of the other’: cl 2(1)(c)(ii).

<sup>188</sup> [1975] 3 All ER 382 (Ch D).

<sup>189</sup> However, it is noteworthy that the position in South African law on the meaning of the term ‘class’ in the context of a scheme of arrangement differs from the interpretation followed in *Re Hellenic & General Trust Ltd* supra note 188. The test in South African law is not one of commonality of interests, but instead one of commonality of rights: see Blackman et al op cit note 82 at 12-16-1.

minority group becomes meaningless);<sup>190</sup> in certain circumstances, a formal independent valuation of the shares of the minority may be required; and the appointment of a committee of independent directors acting at arms' length to ensure fairness of the transaction, to negotiate the merger agreement, and to whom solely the independent legal and financial advisors of the company would report.<sup>191</sup> These and other similar measures will no doubt in due course form part of the fiduciary duties of directors as developed by the courts, and may also fairly be expected to form part of the new Takeover Regulations. Directors could also consider voluntarily implementing such additional measures, as part of, and as evidence of their compliance with, their fiduciary duties.

## 9 The Two-step Freeze-out Merger

The two-step merger concept consists of a *take-over offer as the first step*, followed by a *freeze-out merger as the second step*. The purpose of the first step, the take-over offer, is for the offeror to acquire a sufficient number of shares in the offeree company so as to enable it to effect a freeze-out merger as the second step, by voting its newly-acquired shares in the offeree/target company in support of the merger resolution.

Accordingly in the second step, the freeze-out merger, the shares of those minority shareholders who chose not to accept the offer under the first step of the transaction, are acquired by the offeror/acquiring company. In this way the minority shareholders are eliminated from the target company. Even though such a two-step merger initially starts as an arms' length transaction, in the second step of the transaction a freeze-out or a conflict of interest is involved.<sup>192</sup>

The majority-of-minority-vote requirement in cl 119(8) of the Bill seemingly (or implicitly) applies not only to a standard freeze-out merger but also to the two-step merger. This *precludes* the successful take-over bidder from voting its newly acquired target company shares that were acquired in the first step take-over offer, in support of the shareholders' resolution by the target company on the proposed second step merger. Such a provision renders the two-step merger procedure of little use in South African law, by defeating the very purpose of the first step, namely to acquire a sufficient number of shares in the offeree/target company so as to be able to single-handedly approve the second step merger.

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<sup>190</sup> See, eg, OSC Rule 61-501 op cit note 184. Delaware courts also take account of this factor in the entire fairness standard of judicial review in the context of interested mergers: see further Pinto & Branson op cit note 11 at 239-245; Allen & Kraakman op cit note 4 at 465-83.

<sup>191</sup> Ibid. Although directors owe fiduciary duties to all the shareholders as a whole, since the directors of the target company would generally be appointed by the acquiring company in its capacity as the controlling shareholder of the target company, they may in practice favour the interests of the controlling shareholder/acquiring company when negotiating the merger agreement on behalf of the target company: see, eg, *Weinberger v UOP, Inc* supra note 172.

<sup>192</sup> See Brudney & Chirelstein op cit note 178 at 1356-74; Hamilton op cit note 88 at 622.

By contrast, in Ontario an exception is made to the majority-of-minority-voting requirement in a going private transaction under the Ontario Securities Commission Rules.<sup>193</sup> In a second-step business combination, the shares that are tendered in the first-step take-over bid (even if tendered pursuant to lock-up agreements concluded before the bid) may be *included* in the minority approval vote in the second-step merger, even though by that stage those shares are actually held by the acquiring company/successful take-over bidder. The policy reason underlying this exception is that the shareholders who tendered their shares in the first step are effectively taken to have approved of the entire transaction. This is regarded in Ontario as an incentive for bidders to launch fair bids where they are assured of being able to eliminate the remaining minority shareholders in order to take the company private, so avoiding the onerous burdens associated with a public company.<sup>194</sup>

However many American states have adopted a different approach. As many as 33 states<sup>195</sup> have enacted anti-take-over statutes restricting the acquirer's ability to effect such a second-step or back-end freeze-out merger. Subject to certain exemptions, these statutes usually restrict a bidder who acquires more than a specified percentage of the target's stock from engaging in a second-step merger for a specified period. For instance in New York and Delaware interested shareholders who hold in excess of 10 per cent and 15 per cent, respectively, of the target company's shares, are precluded from effecting any business combination with the target for a period of between three and five years unless certain specific exemptions, designed to curb the coercion of minority shareholders, apply.<sup>196</sup> Moreover, in 27 states various super-majority and fair-price statutes<sup>197</sup> could effectively prevent the acquirer from effecting the second-step freeze-out merger. For example, Delaware's legislation<sup>198</sup> requires a favourable vote of 66,6 per cent of the target company's disinterested shareholders for certain business combinations between the target company and an interested shareholder who has acquired more than 15 per cent of the target company's voting shares without the prior approval of the target company's directors, as will occur in a take-over offer.

It is thus clear that there are divergent and conflicting policies relating to the two-step freeze-out merger. The conservative approach adopted, albeit implicitly, in the Companies Bill as regards the two-step merger is arguably the better approach that favours minority protection. But the entrenchment of this provision in a statute may, in the long term, hamper flexibility and adaptability to new policies and business practices relating to the two-step merger. A more flexible approach would have been for the provisions of cl 119(8) to have been included as part of the Takeover Regulations, which

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<sup>193</sup> OSC Rule 61-501 op cit note 184.

<sup>194</sup> See Nicholls op cit note 101 at 415.

<sup>195</sup> See Practical Law Company op cit note 145 at 430.

<sup>196</sup> Ibid; Kenyon-Slade op cit note 9 at 60.7.

<sup>197</sup> See Practical Law Company op cit note 145 at 430.

<sup>198</sup> See s 203 of the Delaware General Corporation Law, 2001; Kenyon-Slade op cit note 9 at 26.



would be more adaptable than primary legislation, or, alternatively, for cl 119(8) to permit certain exceptions and carve-outs to be fashioned by the Takeover Regulations as the need arises.

## 10 The Short-form Merger

It is a surprising and a most disappointing oversight for the Companies Bill not to make provision for a short-form merger procedure. A short-form merger is a simplified form of a merger between a holding company and its wholly-owned subsidiary, called a vertical short-form merger, or between two wholly-owned subsidiaries of a holding company, known as a horizontal short-form merger. While the Bill expressly permits mergers between a holding company and its subsidiary,<sup>199</sup> it surprisingly fails to provide a special procedure to facilitate such mergers.

The short-form merger procedures in other leading jurisdictions, such as Canada<sup>200</sup> and New Zealand,<sup>201</sup> dispense with the requirement for a shareholder resolution by each of the merging companies and instead permit vertical or horizontal short-form mergers to be effected simply by a resolution of the board of directors of each merging company. This avoids the delay, the costs and the inconvenience associated with convening a shareholder meeting, and, more importantly, with the exercise of appraisal rights.<sup>202</sup> The short-form procedure also dispenses with the requirement of a merger agreement.<sup>203</sup>

The feasibility of the short-form merger has been recognised and recommended even in England<sup>204</sup> and Australia,<sup>205</sup> both of which jurisdictions have rejected the general concept of a 'court-free' merger procedure. The benefit of the short-form merger procedure is that it enables companies to reorganise their group structures and to eliminate subsidiaries which are otherwise kept in existence only in order to avoid the problem and the expense of getting rid of them.<sup>206</sup> The introduction of the short-form merger clearly has economic, administrative and tax benefits and will reduce complexity and compliance costs, all of which are relevant to the underlying objective of company-law reform.

It ought surely to be within the discretion of the board to approve such holding and wholly-owned subsidiary company transactions by way of a

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<sup>199</sup> Clause 117(1) of the Bill.

<sup>200</sup> See s 184 of the Canada Business Corporations Act, 1985.

<sup>201</sup> See s 222 of the New Zealand Companies Act, 1993.

<sup>202</sup> See Hamilton *op cit* note 88 at 623.

<sup>203</sup> See s 184 of the Canada Business Corporations Act, 1985 and s 222 of the New Zealand Companies Act, 1993.

<sup>204</sup> In England the statutory-merger procedure was found to be feasible in the case of mergers of wholly-owned subsidiaries of parent companies: see the Company Law Review Steering Group *op cit* note 71 in par 11.50; Company Law Review *op cit* note 156 in par 13.14.

<sup>205</sup> In Australia, the Companies & Securities Advisory Committee *Corporate Groups Final Report* (May 2000) at 84-5, available at <http://www.takeovers.gov.au> (last visited on 30 May 2007) recommended that the short-form merger procedure be implemented.

<sup>206</sup> See the Company Law Review Steering Group *op cit* note 71 in par 11.50.

short-form merger procedure without the need for shareholder approval.<sup>207</sup> In any event, since the sole shareholder of the subsidiary company is the holding company, its favourable vote on the merger would be a non-issue, while the impact of the merger upon the shareholders of the holding company is unlikely to be material. This is because through the holding company they already indirectly hold a 100 per cent interest in the subsidiary company. Nor would they be eliminated as shareholders pursuant to the merger. And there would be no new shareholders as a result of the merger.<sup>208</sup>

The short-form merger mechanism is much less controversial than other forms of mergers, as it simply involves a parent company and its wholly-owned subsidiaries with *no* outside or minority shareholders. Furthermore, the issues of creditor protection and third-party rights under contracts with the wholly-owned subsidiary company are minimised in such mergers.<sup>209</sup> It is therefore most regrettable that the Bill ignores the short-form merger procedure. Happily, it is not yet too late to remedy this obvious oversight.

Some American states are even more liberal in the realm of short-form mergers in permitting such a merger not only where the holding company holds 100 per cent of the shares in the subsidiary company, but also where it holds at least 90 per cent of the shares in the subsidiary company.<sup>210</sup> This is, in effect, a short-form *freeze-out* merger procedure, by which the minority shareholders are frozen out or eliminated from the subsidiary company *unilaterally*, simply by a resolution of the board of directors, with a shareholder vote on the merger being bypassed. The justification for this approach is corporate efficiency and the acceptance of the policy approach that it is legitimate and normal for an American parent company to want to eliminate small minorities by a unilateral cash-out.<sup>211</sup> The short-form merger in America is thus a simple and inexpensive means of accomplishing a freeze-out<sup>212</sup> which is, additionally, not required to comply with the entire fairness standard<sup>213</sup> that usually applies to freeze-out transactions, something already alluded to earlier.<sup>214</sup> But, it is submitted that in South Africa such a

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<sup>207</sup> See the Australian Companies & Securities Advisory Committee op cit note 205 at 84.

<sup>208</sup> See Hamilton op cit note 88 at 623.

<sup>209</sup> This is because in practice, creditors of wholly-owned subsidiaries and (third) parties to agreements with wholly-owned companies, place reliance on the good faith and credit of the parent company of the wholly-owned subsidiary, something that the merger will not alter: see Davies op cit note 61 at 801.

<sup>210</sup> See, eg, s 11.05 of the Model Business Corporation Act, 1984, as amended s 253 of the Delaware General Corporation Law, 2001.

<sup>211</sup> See Allen & Kraakman op cit note 4 at 436; Iacono op cit note 120 at 657.

<sup>212</sup> The trend towards the liberalisation of short-form mergers in America has also resulted in the abolition of the vote of the board of the *subsidiary* company in respect of the merger: see s 11.05(a) of the Model Business Corporation Act, 1984, as amended; s 253(a) of the Delaware General Corporation Law, 2001. It is further noteworthy that the 1999 amendments to the Model Business Corporation Act now also permit a downstream short-form merger where the surviving company is the *subsidiary* company, as opposed to the usual upstream short-form merger where the holding company is the surviving company.

<sup>213</sup> See *Glassman v Unocal Exploration Corp* 277 A 2d 242 (SC Del, 2001).

<sup>214</sup> See notes 183 and 190 above.

short-form freeze-out merger is inappropriate and conspicuously out of line with the minority shareholder-protection measures of the Bill, such as those contained in cl 119(2)(b) and (8).

It is further noteworthy that many American corporate-law statutes eliminate the need for a vote of the shareholders of the acquiring company in what is called a ‘whale-minnow merger’,<sup>215</sup> that is, a small acquisition by which the acquiring company does not issue more than a specified percentage of its shares as a merger consideration (usually no more than 20 per cent of the number of issued shares that were in issue prior to the merger).<sup>216</sup> The shareholders of the acquiring company are disentitled both to voting and to appraisal rights in a whale-minnow merger. This is justified on the basis that the transaction is a small one, and by no means a merger of equals, so that the impact on the shareholders of the acquiring company is not sufficiently significant to merit a shareholder vote.<sup>217</sup> In South Africa, too, this would be inappropriate in the light of the relative discrepancies in the size, scale and complexity of our economy and our companies.

Having addressed various popular merger structures that are permissible under the Bill, I will now examine the innovative appraisal right in some detail and will then also discuss more fully the requirement of court approval of a merger in certain exceptional circumstances, while also noting, where appropriate, the interplay between the two notions.

## 11 The Appraisal Right and Court Approval: General

The statutory merger is in essence a simple, uncomplicated and effective procedure by which two or more companies may merge by agreement with the approval of the prescribed majority of their shareholders, without the need for the approval of the merger by a court. Instead of recourse to a court, dissenting shareholders have the right to opt out, by withdrawing the fair value of their shares in cash, as a result of the exercise of their appraisal rights.

Shareholders who are eligible to vote on, and who dissent from, a merger may be entitled to appraisal rights under cl 165 of the Companies Bill. The appraisal right is the dissenting shareholder’s right to seek judicial determination of the fair value of its shares.<sup>218</sup> The underlying justification and object of the appraisal right are of importance in analysing the Bill and are best understood in the context of American law.

Appraisal is an American concept that was introduced there over a century ago. Historically, mergers and other fundamental transactions in America required the *unanimous* approval of all the shareholders of a company. But

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<sup>215</sup> See Clark op cit note 16 at 450.

<sup>216</sup> See, eg, s 251(f) of the Delaware General Corporation Law, 2001; s 12.03 of the Model Business Corporation Act, 1984, as amended.

<sup>217</sup> See Clark op cit note 16 at 418.

<sup>218</sup> See Allen & Kraakman op cit note 4 at 452.

with the development of commerce towards the end of the nineteenth century, a more flexible and facilitative approach to mergers was adopted with the result that the legislatures lowered the unanimity rule, but, as a quid pro quo, granted to those shareholders who had dissented from a merger the remedy of appraisal.<sup>219</sup>

Originally, when the consideration in mergers was limited to securities and not extended to a cash consideration, appraisal was justified as an exit mechanism. Dissenting shareholders who objected to a merger were entitled to be paid by the company the fair value of their shares in cash and in this way to exit the company. Failing that possibility, a dissenting shareholder would otherwise have been locked into a new merged company, with a different set of assets and risks, in which it may have had no desire to invest.<sup>220</sup> This may be regarded as what has been labelled as the 'defeated expectations' view,<sup>221</sup> namely, that a shareholder may expect to remain as a shareholder in the particular company in which it holds shares and to not be compelled by a merger to hold an investment in quite a different business.

With the increasing liberalisation in the statutory regulation of mergers and the introduction of cash as a merger consideration, the modern justification for the appraisal remedy is that it serves as a protection for minority shareholders against being cashed-out at an inadequate price or value.<sup>222</sup> This may be regarded as the 'remedy-for-unfairness' justification.<sup>223</sup> Since the directors, and not the shareholders, negotiate the terms of the merger, the directors could easily disregard their duty to obtain the best price for the company, particularly where they are tempted by various side-payments offered as an inducement to them personally by the other merging company. The general body of shareholders may never become aware of such side-payments, thus rendering the safeguard of shareholder approval of the merger an ineffectual protective measure on its own, particularly in view of the possibility of inadequate informational disclosure by directors to shareholders coupled with shareholder apathy. The appraisal right thus functions also as a check on bad business judgments by directors: the greater the number of dissenting shareholders, the more likely it is that the board would be persuaded to reconsider the merger.<sup>224</sup>

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<sup>219</sup> See Bayless Manning 'The Shareholder's Appraisal Remedy: An Essay for Frank Coker' (1962) 72 *Yale L.J.* 223 at 228-9; Allen & Kraakman op cit note 4 at 452. This causal link has more recently been doubted: see, eg, H Kanda & S Levmore 'The Appraisal Remedy and The Goals of Corporate Law' (1985) 32 *University of California in Los Angeles LR* 429 at 436. There has been much vigorous debate in America on the appraisal right, its purpose and the justifications for and against it. However, much of this debate is beyond the scope of this article.

<sup>220</sup> See Pinto & Branson op cit note 11 at 127-8; Allen & Kraakman op cit note 4 at 452-3.

<sup>221</sup> See Clark op cit note 16 at 444. Manning op cit note 219 at 246 disputes this justification for appraisal.

<sup>222</sup> See Hamilton op cit note 88 at 628; Pinto & Branson op cit note 11 at 127-8; Allen & Kraakman op cit note 4 at 452-3.

<sup>223</sup> See Clark op cit note 16 at 445.

<sup>224</sup> M Eisenberg 'The Legal Roles of Shareholders and Management in Modern Corporate Decision Making' (1969) 57 *California LR* 1 at 85-6; Kanda & Levmore op cit note 219 at 443-4; Clark op cit note 16 at 445.

The three important objects of appraisal are thus that it facilitates the market for mergers; provides liquidity to dissenting shareholders; and serves as a check on opportunism by the directors and the controlling shareholders.<sup>225</sup> Appraisal is a remedy that reconciles ‘the need to give the majority the right to make drastic changes to the enterprise to meet new conditions as they arise, with the need to protect the minority against being involuntarily dragged along into a drastically restructured enterprise in which it has no confidence’.<sup>226</sup>

A dissenting shareholder is entitled to demand the fair value of its shares from the company, but only if the following requirements in terms of the Bill have been satisfied. First, the shareholder must send a written notice to the company objecting to the merger resolution, and must do so at or before the shareholders’ meeting convened to vote on the resolution.<sup>227</sup> Secondly, the resolution must afterwards have been adopted by the company. Thirdly, the resolution must have been supported by less than 75 per cent of the shares entitled to be voted: a vote that exceeds this threshold, with the consequence that appraisal is denied to the dissenting shareholders, will be referred to as the ‘no-appraisal threshold’.<sup>228</sup> Fourthly, the shareholder must vote its shares in opposition to the merger resolution. And fifthly, the shareholder must comply with the procedural requirements of cl 165.<sup>229</sup>

It is noteworthy that the appraisal right is granted only to those shareholders who are entitled to vote on a merger resolution. Accordingly, it is submitted that only registered shareholders would be entitled to dissent and not also beneficial shareholders. Furthermore, dissent rights would not extend to those shareholders who are precluded from voting on a merger resolution in terms of cl 119(8) of the Bill, nor would it extend to those shareholders who do not hold ‘voting shares’ as defined. The Bill ought to make it clear that a partial dissent is not permissible, that is, that a shareholder must dissent in respect of *all* (and not only some) of the shares which it holds in a particular class; this would prevent shareholders from hedging their bets. However, an exception to the partial dissent rule should be granted to a registered shareholder holding shares on behalf of a number of beneficial shareholders, where only some and not all of the beneficial shareholders wish to object, provided that the registered shareholder objects in relation to *all* the shares held by each beneficial shareholder who wishes to object.<sup>230</sup>

The appraisal procedure as set out in cl 165 is complex and technical, involving a number of specified notices each coupled with a prescribed time

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<sup>225</sup> Richard T Hossfeld ‘Short-Form Mergers after *Glassman v Unocal Exploration Corp.*: Time to Reform Appraisal’ (2004) 53 *Duke LJ* 1337 at 1345.

<sup>226</sup> Cary & Eisenberg op cit note 18 at 1104, quoting Melvin Eisenberg *The Structure of the Corporation* (1976) at 78.

<sup>227</sup> Clause 165(2) of the Bill. This is subject to an exception in terms of cl 165(5).

<sup>228</sup> The no-appraisal threshold is considered critically in par 12 below.

<sup>229</sup> Clause 165(4) of the Bill.

<sup>230</sup> See in this regard the comparable provisions in s 13.03(a) of the Model Business Corporation Act, 1984, as amended, and s 190(4) of the Canada Business Corporations Act, 1985.

limit for completion. A shareholder must comply meticulously with each procedural step in order to ‘perfect’ and exercise its appraisal right. This renders the appraisal procedure a potential minefield for dissenting shareholders.

A number of steps are necessary and mandatory to ‘perfect’ the appraisal right.<sup>231</sup> Not only must the dissenting shareholder send a written notice of objection to the company and vote against the resolution in respect of the merger,<sup>232</sup> but it must in addition afterwards also deliver to the company, within a specified time period,<sup>233</sup> a written demand to be paid the fair value of its shares. This demand ‘must’ contain certain specified information.<sup>234</sup>

Once the shareholder’s appraisal right has been so perfected, the company makes a written offer to the shareholder to pay an amount considered by the directors to be the fair value of the relevant shares.<sup>235</sup> Ideally the shareholder and the company will agree on the value of the shares. If the shareholder considers the company’s offer to be inadequate, or in the event that the company fails to make an offer, then, provided that the offer has not lapsed, the shareholder may apply to the court for a judicial determination of the ‘fair value’ of the relevant shares.<sup>236</sup> The flaws, defects and limitations of the appraisal procedure will shortly be considered critically.<sup>237</sup>

The Bill is silent as to the meaning of the key phrase ‘fair value’ of the dissenting shareholder’s shares, as well as on the appropriate method of valuation in these circumstances. The valuation of dissenters’ shares will be considered shortly.<sup>238</sup>

Where a proposed merger has been approved by the requisite majority of the shareholders of a company, the dissenters are not generally able to prevent or frustrate the merger against the wishes of that majority. Instead, their recourse would be to rely on their appraisal rights. It is only in certain exceptional circumstances that a statutory-merger resolution may be set aside by the court on the grounds specified by cl 119(6) of the Bill. These grounds are considered in greater detail below.<sup>239</sup>

Clause 119(6) accordingly empowers the court to set aside a resolution before it is implemented by the company. This ‘remedy’ must be distinguished from and not be confused with the appraisal remedy as the two remedies provide different results and apply in different circumstances. While the appraisal remedy is concerned with the determination of the fair value of

<sup>231</sup> Clause 165(4)(d)(ii) of the Bill.

<sup>232</sup> Failing which, in terms of cl 165(4), the shareholder loses its appraisal right.

<sup>233</sup> The demand must, in terms of cl 165(6), be delivered within 20 days of receipt of notice from the company that the resolution was adopted or, in the event that the shareholder does not receive a notice from the company, within 20 days of learning of the adoption of the resolution.

<sup>234</sup> The specified information in the demand consists of the shareholder’s name and address, the number and class of shares in respect of which the shareholder dissents and a demand to be paid the fair value of its shares: see cl 165(7).

<sup>235</sup> Clause 165(10) of the Bill.

<sup>236</sup> Clause 165(13) of the Bill.

<sup>237</sup> See par 13 below.

<sup>238</sup> See par 14 below.

<sup>239</sup> See pars 15 below and 3.2 above.

shares in the company and does not prevent the implementation of the merger, the cl 119(6)- requirement of court approval is concerned with the review of the merger resolution and the possible setting aside of the transaction. Relevant aspects of the interplay between the appraisal right and court approval of mergers will be referred to where appropriate in what follows.

## 12 The No-appraisal Threshold

The no-appraisal threshold, as explained earlier, is the disenfranchisement of dissenting shareholders from their rights to an appraisal. It occurs if a merger resolution has been approved by 75 per cent or more of the shares entitled to be voted. It is submitted that, in view of the underlying object of the appraisal right of a dissenting shareholder, the no-appraisal threshold in terms of the Bill is manifestly and strikingly inappropriate.

The no-appraisal threshold creates much scope for unfairness to minority shareholders. This is severely exacerbated in the case of companies dominated by a controlling shareholder holding 75 per cent or more of its shares which enables that shareholder to single-handedly approve of any merger of the company, including the merger price, and, worse, also to deny appraisal rights to dissenting minority shareholders. The no-appraisal threshold fails minority shareholders in two ways. First, it fails to provide liquidity for dissenting shareholders. And secondly, it fails to serve as an effective check on opportunism by controlling shareholders. It is accordingly submitted that the no-appraisal threshold provided for in the Bill is undesirable and clearly out of keeping with the very object of the appraisal right. It must, one would suggest, be excised from the Bill. Not surprisingly, no comparable limitation on the appraisal right is to be found in any of the leading jurisdictions, including America under the Model Business Corporation Act, 1984, as amended, Delaware, Canada and New Zealand.

Despite the influence and prominence of Manning's<sup>240</sup> attack on the appraisal remedy in America, appraisal has nonetheless been retained there. In this regard, Manning contends that appraisal serves no economic purpose for a company that must purchase the appraised shares, particularly since it may be forced to liquidate assets in order to do so. Furthermore, the appraisal remedy is not of much use to the dissenting shareholder as it is costly, procedurally complex, lengthy and often yields unpredictable awards. But other academics have dismissed Manning's contentions.<sup>241</sup> If the merger is a good one, the directors ought to be able to obtain the support of the minority shareholders or, alternatively, to obtain the necessary finance in order to buy out the dissenters at a fair value. Additionally there are doubts whether in practice the potential cash drain occasioned by a large number of dissenters

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<sup>240</sup> Op cit 219 at 223.

<sup>241</sup> See, eg, Eisenberg op cit note 224 at 72-4.

really does in fact result in the abandonment of the merger.<sup>242</sup> Accordingly, the no-appraisal threshold under the Bill cannot be justified by the cash-drain argument.

It also cannot be properly asserted that the no-appraisal threshold is justifiable on the basis that if the holders of 75 per cent of the eligible shares vote in favour of a merger, this is sufficient evidence of the fairness of the merger price. Other factors also come into play, such as shareholder apathy, flawed information disclosure, the presence of a dominant majority shareholder, market depression, or the fact that the shares in question are not listed or actively traded.

Indeed, the no-appraisal threshold is particularly objectionable in respect of dissenting shareholders who are unable to sell their shares on the open market and who have no real alternative but to accept the merger consideration. This occurs, for instance, where the shares are unlisted or not widely traded, or where for some reason or another the market for the shares is otherwise not liquid. Even where the shares are listed and could in theory be sold by dissenting shareholders on the open market, the appraisal remedy is nevertheless required. That is so because the financial markets are notoriously imperfect.<sup>243</sup>

Neither the Canada Business Corporations Act nor the New Zealand legislation has a market-exception provision denying appraisal rights to shareholders. Although some American states deny appraisal by way of a market-exception or 'market-out' provision that applies to the holders of shares that are traded in a liquid market (that is, listed shares or widely traded shares with more than two thousand record shareholders) and where the value of the shares is reliable, this exception to the appraisal right only applies generally where the merger consideration is also liquid in that it consists of cash or other liquid securities.<sup>244</sup>

A practical consequence of the denial of appraisal rights to a disgruntled shareholder affected by the no-appraisal threshold under the Companies Bill is that, in finding itself left with no real recourse, it may be tempted out of desperation or frustration to apply for court approval of the merger, in the hope that the court might review the merger resolution and set it aside in terms of under cl 119(6) of the Bill, even in circumstances where it may have no real grounds for success. This causes delay in the implementation of the merger and increases the costs for the company, particularly since the company has to bear the costs of the court application where the disgruntled minorities who unanimously call for court approval of the merger hold 15 per cent or more of the shares that were voted against the merger resolution.<sup>245</sup>

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<sup>242</sup> See Clark *op cit* note 16 at 446.

<sup>243</sup> See further par 14 below.

<sup>244</sup> See s 13.02(b)(3) of the Model Business Corporation Act, 1984, as amended; s 262(b)(2) of the Delaware General Corporation Law, 2001.

<sup>245</sup> Clause 119(3)(a) and (4) of the Bill. As discussed earlier in par 3.2 above, where the holders of at least 15 per cent of the shares that were voted on the resolution both voted against its adoption and also



While the possibility of an application for court approval of the merger could well on the one hand operate as a general check on managerial unfairness to minority shareholders (especially since the end result may be that the company treats the adopted merger resolution as a nullity),<sup>246</sup> it would on the other hand be open to abuse by the minority shareholders in these circumstances.

Notwithstanding these considerations, the requirement of court approval of a merger under the Bill cannot correctly be said to function as a general safety-net providing some recourse to disgruntled shareholders who are adversely affected by the no-appraisal threshold. This is because an application for court approval may carry with it strong disincentives for the disgruntled shareholders in certain circumstances. First, the disgruntled shareholder(s) may not be able to establish the grounds for court approval as specified in cl 119(6) of the Bill. And secondly, if disgruntled shareholder(s) who unanimously call for court approval of the merger do not hold at least 15 per cent of the shares voted against the merger,<sup>247</sup> then one or more of them will first have to make a successful application for leave to apply to court for a review of the transaction.<sup>248</sup> Moreover, the costs of the application for court approval will not necessarily be imposed on the company.<sup>249</sup> Thus, notwithstanding the requirement for court approval of the merger in some cases, the no-appraisal threshold fashioned by the Bill is most inappropriate and glaringly out of keeping with the purpose and the justification of the appraisal right.

Finally, if the motivation underlying the no-appraisal threshold in terms of the Bill is concern on the part of the Legislature that some protection must be provided for the company and the majority shareholders against minority dictation by way of the exercise of the appraisal right in these circumstances, then a more appropriate course of action might be to permit the company to apply to the court for relief where appraisal would be inequitable or unjust to it.<sup>250</sup> It is accordingly submitted that there is no valid justification for the

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unanimously require the company to seek court approval of the transaction, the company may either treat the resolution as a nullity (cl 119(4)(b)) or may apply to the court for approval, in which case the company must bear the costs involved (cl 119(4)(a)).

<sup>246</sup> In terms of cl 119(4)(b). See note 245 above.

<sup>247</sup> With the result that they will be unable to rely on cl 119(3)(a) and (4).

<sup>248</sup> See cl 119(3)(b) and (5), discussed in par 3.2 above. These measures provide that the court's approval of a merger resolution is required where a successful application for leave to apply to court for a review of the transaction is made by a shareholder who had voted against the adoption of the resolution (cl 119(3)(b)). The court may grant such leave to apply for a review of the transaction only if it is satisfied that the applicant is in good faith, appears prepared to sustain the proceedings, and has alleged facts which if true would support an order to set aside the resolution (cl 119(5)).

<sup>249</sup> Since cl 119(4)(a) is inapplicable in these circumstances.

<sup>250</sup> Such a remedy may be found in the buy-out provisions contained in s 111 of the New Zealand Companies Act, 1993. It was designed to avoid minority oppression of the majority (see the New Zealand Law Commission, *Company Law: Reform and Restatement* (1989) in par 207, referred to by Grantham & Rickett op cit note 4 at 750) and enables New Zealand courts to exercise wide powers in order to achieve a fair result for the company. However, it is submitted that this sort of remedy is unnecessary in the context of the Companies Bill.

no-appraisal threshold under the Bill: it is inappropriate and ought to be removed from the Bill.

### 13 Flaws and Limitations of the Appraisal Procedure

Turning to a critical analysis of the appraisal procedure in terms of cl 165 of the Companies Bill, it is submitted that the severe procedural limitations of the appraisal procedure detract to a large extent from its effectiveness as a shareholder-protection measure. Not only does the complexity and the rigidity of the procedural steps make it difficult for a shareholder to exercise its appraisal rights without legal assistance and attendant legal expenses, but the dissenting shareholder may also lose its appraisal right upon failure to comply with certain procedural steps within the many specified time periods. The appraisal procedure moreover is skewed in favour of the company in that the latter suffers no similar adverse consequences for noncompliance on its part with its complementary procedural obligations.

To expand on this, the shareholder loses its appraisal right if it fails to send the company both a written notice of objection and a written demand within the time limits prescribed by the Bill.<sup>251</sup> But if the company fails to send its two requisite notices to shareholders, namely the notice of the shareholders' meeting to vote on the merger resolution together with a statement of the cl-165 rights,<sup>252</sup> and the notice to objecting shareholders of the adoption of a resolution approving the merger,<sup>253</sup> the company suffers no adverse consequences.<sup>254</sup> Likewise, if the company fails to make a written offer to pay the fair value of their shares to the relevant shareholders, there are once again no adverse consequences for the company,<sup>255</sup> but the shareholder again is given a specified period of only 30 days after the company's written offer (if any) to apply to the court to determine a fair value of its shares, after which the written offer lapses<sup>256</sup> and the shareholder apparently loses its right to apply to the court for a judicial appraisal.<sup>257</sup>

The imbalance inherent in these provisions operates in favour of the company and harshly against the shareholder, resulting in great potential for unfairness to a dissenting shareholder who may lose its appraisal right upon an unwitting failure to comply with one of the many technical and complex steps prescribed by the Bill. This is particularly inappropriate in view of the

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<sup>251</sup> These were discussed in par 11 above.

<sup>252</sup> See cl 117(5) of the Bill.

<sup>253</sup> See cl 165(3) of the Bill.

<sup>254</sup> If the company fails to give the former notice or fails to include in it a statement of the cl-165 rights, the only consequence is that the shareholder is excused from sending a notice of objection to the company: see cl 165(5). If the company fails to send the latter notice, the only consequence is that the shareholder's prescribed 20-business-day period within which to deliver to the company a written demand starts to run from the day that the shareholder learns of the adoption of the resolution: see cl 165(6)(b)).

<sup>255</sup> See cl 165(13)(a) of the Bill.

<sup>256</sup> The offer lapses within 30 days after it was made in terms of cl 165(11)(b).

<sup>257</sup> See cl 165(13)(b) of the Bill.

fact that generally the company, but not the dissenting shareholder, would have ready access to and funds for legal representation and proper guidance in complying with the many procedural steps. While the underlying purpose of the procedural steps may be worthy in promoting and encouraging settlement between the company and the dissenters without resorting to *judicial appraisal*,<sup>258</sup> it is nonetheless submitted that the balance drawn by the Bill between the dissenting minority and the company has to be adjusted.

The Bill ought to provide for greater latitude for shareholder compliance with its procedural obligations. The court should be given a discretionary power to extend the prescribed time limits for a dissenting shareholder to comply with prescribed procedural steps and in appropriate cases to condone a shareholder's non-compliance with the procedure. It is furthermore to be hoped that courts would interpret the dissenting shareholder's procedural obligations as flexibly and as leniently as possible, so as to excuse the lack of strict compliance by a shareholder despite a genuine attempt by it to comply with the prescribed procedure. This was exactly the approach adopted in *Jepson v Canadian Salt Co Ltd*<sup>259</sup> in relation to the appraisal procedure prescribed by the Canada Business Corporations Act. In parallel with these suggestions and to simultaneously encourage companies to likewise comply with their respective procedural obligations, it may be advisable to insert a costs provision in the Bill to the effect should the company fail to comply with the appraisal procedure prescribed by the Bill, costs will at the discretion of the court be assessed against the company.<sup>260</sup>

A second procedural flaw of appraisal (apart from the complexity and rigidity of the procedural steps imposed on the dissenting shareholder) is the delay experienced by dissenting shareholders when exercising their appraisal rights. Once a shareholder sends the written demand to the company, the shareholder loses all further rights in respect of those shares other than to be paid their fair value.<sup>261</sup> But the fair value is paid only at the end of the appraisal proceedings.<sup>262</sup> Until then the shareholder is deprived of the use of his funds. It is submitted that a better approach would be to require the company to pay in cash *a provisional amount*, being the company's estimate of the fair value of the relevant shares, at an earlier stage. This would give the

<sup>258</sup> For example, the purpose of requiring the shareholder's notice of objection to be given at or before the shareholders' meeting, is to alert to the company to the number of dissenters, thus enabling it to estimate the amount of the cash payment which will be required upon appraisal: see Clark op cit note 16 at 450. Indeed, the Bill expressly makes provision for the eventuality that the company may revoke the adopted resolution after receipt of the dissenters' notices of demand: see cl 165(8)(c)).

<sup>259</sup> [1979] 4 WWR 35, 99 DLR (3d) 513 (SC, Alta), in relation to s 184 (now s 190) of the Canada Business Corporations Act, 1985, which has procedural requirements similar to those of the Bill. See also Bruce Welling *Corporate Law in Canada: The Governing Principles* 2 ed (1991) at 576-8. *Jepson's* case may be compared to *Denischuk v Bonn Energy Ltd* (1983) 30 Sask R 37 (Sask QB) which held that where there has been a *complete* failure to comply with a statutory requirement, the appraisal remedy will be unavailable to the shareholder.

<sup>260</sup> See, eg, s 13.31(b)(1) of the Model Business Corporation Act, 1984, as amended.

<sup>261</sup> See cl 165(8) of the Bill.

<sup>262</sup> Unless the dissenting shareholder accepts the company's written offer to pay the fair value (as discussed in par 11 above), the company only pays the dissenting shareholder the fair value of its shares after a judicial determination of the fair value accompanied by an order in terms of cl 165(14)(b)(v)(bb).

dissenting shareholder the immediate use of its funds, while any dispute between the company and the dissenting shareholders concerning the (total) fair value (that is, the as yet unpaid balance of the fair value) would be determined at the judicial appraisal proceedings. This is the approach adopted in the American Model Business Corporation Act,<sup>263</sup> although not in Delaware. Similarly, in New Zealand the minority buy-out provisions provide that the company must pay a provisional price to the dissenting shareholder pending the outcome of the arbitration proceeding to determine the due balance of the fair and reasonable price that remains payable.<sup>264</sup>

A third desirable procedural amendment that would also serve to achieve a more equitable balance between the minority shareholders and the company, relates to the costs of the appraisal proceeding. The Companies Bill presently provides that the court has a discretion to make an appropriate order of costs, having regard to any offer made by the company and the final determination of the fair value by the court.<sup>265</sup> Although the discretionary nature of the costs order may, to some extent, encourage parties to reach agreement in good faith on the fair value of the shares without frivolously resorting to the courts, the costs should not serve as a disincentive to the assertion of the appraisal right by the shareholder. Valuation of shares is not an exact science but merely a prediction or an estimate and a judicial determination of the fair value creates uncertainty<sup>266</sup> and a substantial risk that the shareholder's estimate of the fair value may be higher than the valuation made by the court. Indeed, the court's determination may even be less than that offered by the company in the merger.<sup>267</sup> Fair value is *a range of values* and not a particular figure, as suggested by the wording of cl 165 of the Bill<sup>268</sup> which provides that the court must determine '*a*' fair value and not '*the*' fair value.<sup>269</sup> Appraisal can thus be prohibitively costly to a dissenting shareholder.

It is accordingly suggested that the Bill ought to confer a wider discretion on the court to assess costs as it finds *equitable*, and as against the company or the dissenter wherever the court finds that it has acted arbitrarily, vexatiously or in bad faith.<sup>270</sup> This would give the court a wider discretion to avoid imposing a costs order on a dissenter despite the approximation of the court's determination of fair value with the company's offer, in circumstances where the shareholder's stance was not arbitrary, vexatious or in bad faith. This would also take into account the possibility that the company's statement

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<sup>263</sup> See s 13.24 of the the Model Business Corporation Act, 1984, as amended.

<sup>264</sup> See s 112(4) of the New Zealand Companies Act, 1993. The minority buy-out right in New Zealand is quite different from the comparable provisions in Delaware, Canada, in America in terms of the Model Business Corporation Act, 1984, and the provisions under the Bill, as the New Zealand company which receives a notice of dissent has four options under s 111, one of which is to purchase the dissenter's shares.

<sup>265</sup> See cl 165(14)(iv) of the Bill.

<sup>266</sup> See Pinto & Branson op cit note 11 at 128.

<sup>267</sup> Ibid.

<sup>268</sup> This is also suggested by the wording of cl 4 in relation to the solvency and liquidity test.

<sup>269</sup> See in this regard *Re Domglas Inc; Domglas v Jarilowsky* [1980] 13 BLR 135 (SC Que).

<sup>270</sup> See, eg, s 13.31(b) of the Model Business Corporation Act, 1984, as amended.

showing how it had determined the fair value (which statement must accompany the company's offer to dissenters)<sup>271</sup> may not necessarily be convincing enough for the reasonable shareholder. As discussed above, the Bill ought also to provide further in relation to costs that should the company substantially fail to comply with its procedural appraisal obligations, costs would be assessed against it.

A final recommended amendment to the appraisal procedure under the Companies Bill is that rather than placing the burden on the dissenting shareholder to initiate judicial appraisal,<sup>272</sup> the burden should be placed on the company, as is presently the case under the American Model Business Corporation Act.<sup>273</sup> In addition, the Bill ought to extend the time limit for a dissenting shareholder to apply to court.<sup>274</sup> The current position under the Bill may be contrasted with the Canada Business Corporations Act, which not only places the initial obligation on the company to apply to court, but also gives the dissenting shareholder more time to consider its options and to decide whether or not to launch an application to court.<sup>275</sup>

It is submitted that cumulatively the above defects and shortcomings of the appraisal procedure result in the appraisal remedy being somewhat ineffective as a form of protection for shareholders. As pointed out by Manning,<sup>276</sup> the appraisal procedure fails to assist the shareholder effectively partly because of it being costly, technical, lengthy and often yielding unpredictable awards. Perhaps the amendments to the appraisal procedure as suggested above would serve to render it a more effective remedy, without at the same time imposing too heavy a burden on the company.

## 14 Determining Fair Value in Appraisal: Valuation

The appraisal provision in the Companies Bill requires the court to determine 'a fair value' of the shares of dissenting shareholders.<sup>277</sup> The Bill states that the time for valuation is 'the date on which, and time immediately before, the company adopted the resolution' relating to the merger.<sup>278</sup> However, the Bill is silent on the method of valuation. In a similar vein, both the Canada Business Corporations Act and the New Zealand Companies Act

<sup>271</sup> Clause 165(10) of the Bill.

<sup>272</sup> Clause 165(13) of the Bill.

<sup>273</sup> See, eg, s 13.30(a) and (b) of the Model Business Corporation Act, 1984, as amended. Also, if the company fails to initiate the judicial proceeding, it is obliged to pay the dissenters the amount which they had estimated to be the fair value for their shares (in terms of s 13.26) over and above the provisional payment: see s 13.30(a).

<sup>274</sup> As explained earlier, the dissenting shareholder must apply to court within 30 days after any offer made by the company (in terms of cl 165(10)), after which the offer lapses: see cl 165(13).

<sup>275</sup> Section 190(15) and (16) of the Canada Business Corporations Act, 1985, provides that after the lapse of the 30-day period after any offer made by the corporation to the dissenting shareholder, the corporation has 50 days from the date that the resolution takes effect to apply to court, and if the corporation does not do so within that time, the shareholder may apply to court within the following 20 days.

<sup>276</sup> Op cit note 219 at 230-2.

<sup>277</sup> Clause 165(14)(c)(ii) of the Bill.

<sup>278</sup> Clause 165(15) of the Bill. See also s 190(3) of the Canada Business Corporations Act, 1985.

are silent on the method of valuation in appraisal proceedings.

Although the issue of the fair price of shares has been considered in South African law in the context of the oppression remedy in s 252 and the mandatory acquisition of the shares of minorities under s 440K of the Companies Act, the same factors and arguments do not necessarily apply in cases where fair value is being assessed for the purpose of the appraisal remedy. The difference lies in the fact that in the former situations the shareholder is effectively being forced out of the company, while in the context of the appraisal remedy this is not necessarily the case.<sup>279</sup> In other words, while the former situations do not constitute a sale by a willing seller to a willing purchaser, in the case of appraisal the vendor is a willing seller who has elected appraisal.<sup>280</sup> As in Canadian<sup>281</sup> and New Zealand<sup>282</sup> law, South African courts are most likely to have recourse to the well-developed Delaware jurisprudence in interpreting 'fair value' in the appraisal context.<sup>283</sup>

It is noteworthy that in Delaware the task of the valuation of shares in appraisal proceedings is performed by the Delaware Court of Chancery, which is a specialist court experienced in valuation.<sup>284</sup> Delaware now clearly defines the dissenting shareholder's claim as a pro rata claim to the value of the firm as a going concern. Thus, the underlying principle of an appraisal proceeding is to value the corporation *itself* and not the shares held by a particular shareholder, and to value it on a going concern basis rather than on a liquidated basis.<sup>285</sup>

It must be stressed that fair value is not equivalent to market value alone. For instance, where the market is thin or the shares are undervalued on the market, the market price of the shares will not reflect the 'fair value' of those shares.<sup>286</sup> This has been long accepted in America.<sup>287</sup> Furthermore, the effect of the merger itself may be to depress the market price of the shares directly, especially where the merger is thought by experts to be unwise. Or the market may be depressed as a result of the sale by a disgruntled shareholder of a very

<sup>279</sup> See Welling op cit note 259 at 586-7 for the Canadian approach.

<sup>280</sup> See David O Jones *Company Law in New Zealand: A Guide to the Companies Act 1993* (1993) at 85 for the New Zealand approach.

<sup>281</sup> See *Re Montgomery* (1980) 111 DLR (3d) 116 (Sask QB).

<sup>282</sup> See Jones op cit note 280 at 85.

<sup>283</sup> Similar to the Bill, s 262 of the Delaware General Corporation Law, 2001 states that the 'fair value' of dissenters' shares must be determined, as does s 190 of the Canada Business Corporations Act, while s 112 of the New Zealand Companies Act, 1993, provides by contrast for a 'fair and reasonable price'. It is also noteworthy that in New Zealand the fair and reasonable price is determined by arbitration: see s 112(4)(a).

<sup>284</sup> See Bainbridge op cit note 9 at 640.

<sup>285</sup> See *Cavalier Oil Corp v Hartnett* 564 A 2d 1137(SC Del, 1989) at 144-5; Allen & Kraakman op cit note 4 at 455.

<sup>286</sup> See A Conard 'Amendments of Model Business Corporation Act Affecting Dissenter's Rights (Sections 73, 74, and 80)' (1979) 33 *Business Lawyer* 2587 at 2595-6 in the context of the 'market out' exception for listed shares and widely traded shares in Delaware law: see s 262(b)(1) of the Delaware General Corporation Law, 2001 and also s 13.02(b) of the Revised Model Business Corporation Act, 1984.

<sup>287</sup> See, eg, *In re Valuation of Common Stock of Libby, McNeill & Libby*, 406 A 2d 54 (SC Del, 1979) at 60; *The Chicago Corporation v Munds* 172 A 452 (Ch C Del, 1934).

large block of shares.<sup>288</sup> The appraisal remedy consequently has an important role to play even in respect of listed shares. Thus, the market value is not the automatic method of valuation since in many circumstances it is not appropriate or reflective of the true worth of the company. Certainly in a freeze-out, the market value of the shares would not generally reflect their fair value, because the majority shareholder that acquires the company under the freeze-out invariably chooses to do so at a time when the market value of the shares is depressed.<sup>289</sup>

The traditional valuation method previously used by American courts was the ‘Delaware Block Method’, which was a weighted average of three different valuation methods, namely market value, net asset value and capitalized earnings. In terms of the method, each element of value was assigned a particular weight.<sup>290</sup> Although the Delaware Block Method of valuation was relatively straightforward for judges to apply, it resulted in arbitrary valuations and could lead to widely divergent results. It made little sense from the perspective of financial and economic theory, and was in need of modernisation and replacement with other valuation methods used in modern practice.<sup>291</sup>

The Delaware Block Method was consequently abandoned by the Delaware Supreme Court in 1983, in the leading case of *Weinberger v UOP Inc.*<sup>292</sup> In this case the Court held that ‘a more liberal approach must include proof of value by any techniques or methods that are generally considered acceptable in the financial community and otherwise admissible in court’.<sup>293</sup> The case accordingly laid down that ‘market value, asset value, dividends, earning prospects, the nature of the enterprise and any other facts which were known or which could be ascertained as of the date of the merger and which throw any light on future prospects of the merged corporation’<sup>294</sup> must be taken into consideration. This is a very wide and flexible method.<sup>295</sup> The court further confirmed that in essence a dissenting shareholder is entitled to be paid for his proportionate interest in a going concern.

After *Weinberger’s* case, the ‘discounted cash flow’ methodology became the most common valuation technique in appraisal cases in America. The discounted cash flow method is based on the premise that the value of a company is equal to the present value of its projected future cash flows. Unlike the Delaware Block Method, the discounted cash flow method looks to

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<sup>288</sup> See Melvin Eisenberg *The Structure of the Corporation* (1976) at 77-82, referred to in Cary & Eisenberg op cit note 18 at 1104-5.

<sup>289</sup> See par 8 above.

<sup>290</sup> See Bainbridge op cit note 9 at 637-9.

<sup>291</sup> *Idem* at 640; Clark op cit note 16 at 455.

<sup>292</sup> *Supra* note 172.

<sup>293</sup> At 713.

<sup>294</sup> *Ibid.*

<sup>295</sup> See Kenyon-Slade op cit note 9 at 75.

the future prospects of a company rather than focusing on its past performance.<sup>296</sup>

It is submitted that South African law must follow the richly developed Delaware jurisprudence on the fair value of shares in appraisal. However, the discounted cash flow methodology is difficult for judges untrained in valuation to apply. American courts now consequently appoint their own experts in appraisal cases.<sup>297</sup> Commendably, the Companies Bill similarly makes provision for the discretionary appointment, by the court, of appraisers to assist in determining fair value.<sup>298</sup>

Turning to the issue of whether shareholders may claim a portion of the gains generated by the merger itself, this has proved to be problematic in American law. Although the Delaware statute provides that the fair value of dissenting shares must be measured ‘*exclusive* of any element of value arising from the accomplishment or expectation of the merger’,<sup>299</sup> the Delaware Supreme Court has put it beyond doubt that ‘elements of future value including the nature of the enterprise which are known or susceptible of proof as of the date of the merger and not the product of speculation may be considered’.<sup>300</sup> In other words, despite the wording of the Delaware statute, the courts have held that only the speculative effects of the proposed merger are to be excluded from the valuation. The Companies Bill does not contain similar restrictive provisions as the Delaware statute, and the wording of cl 165(15) of the Bill would appear to allow scope for adopting the approach of the Delaware Supreme Court to some extent. In this regard, cl 165(15) states that the fair value must be determined at the time immediately before the company *adopted the merger resolution*, not the time before the announcement of the transaction.

Another important factor is the application of discounts to minority shares in the valuation process. In America, minority discounts are thought to be inappropriate, that is, discounts which reduce the appraised value of the shares of the minority shareholders in view of the fact that they do not control the company, so rendering the majority shares worth proportionately more than the minority shares.<sup>301</sup>

The American Model Business Corporation Act, 1984, as amended,<sup>302</sup> now expressly defines ‘fair value’ to implement many of the above elements. It states that ‘fair value’ means the value of the corporation’s shares determined

- immediately before the effectuation of the corporate action to which the shareholder objects (it is noteworthy that since the reference point is the effectuation of the corporate action and not the earlier date of the

<sup>296</sup> *Idem* at 77-8.

<sup>297</sup> See Allen & Kraakman *op cit* note 4 at 456.

<sup>298</sup> Clause 165(14)(c)(iii)(aa) of the Bill.

<sup>299</sup> See s 262(h) of the Delaware General Corporation Law, 2001.

<sup>300</sup> See *Weinberger v UOP Inc* *supra* note 172 at 713; Allen & Kraakman *op cit* note 4 at 456.

<sup>301</sup> See *Cavalier Oil Corp v Hartnett* *supra* note 285; Bainbridge *op cit* note 9 at 644; Kenyon-Slade *op cit* note 9 at 76.

<sup>302</sup> In s 13.01(4).



- shareholder vote on the merger or the announcement of the merger, it appears permissible to take into account any changes in the company's share price in anticipation of the transaction);
- using customary and current valuation concepts and techniques generally employed for similar businesses in the context of mergers; and
  - without discounting for lack of marketability or minority status.

## 15 Further Consideration of the Court Approval of Mergers

### 15.1 Grounds for Setting Aside a Merger Resolution

The exceptional requirement of court approval of a merger<sup>303</sup> is undoubtedly an important provision which serves a distinctly different purpose from the appraisal right, arising as it does mainly from the fact that where there are procedural irregularities or unfairness, the appraisal right is an inappropriate safeguard.

The judicial interpretation of the two grounds on which a court may set aside a merger under cl 119(6)(a) and (b) remains to be seen. These, respectively, are if the 'resolution is manifestly unfair to any class of shareholders', or if 'the vote was tainted by conflict of interest, inadequate disclosure, failure to comply with the Act, the Memorandum of Incorporation or any applicable rules of the company, or other significant and material procedural irregularity'.

However, it is submitted that the latter, cl 119(6)(b), ground would apply where, for example, the company failed to make adequate disclosure to shareholders of sufficient and accurate information to enable them to reach a properly informed decision on how to vote.<sup>304</sup> This involves the failure to disclose information that a reasonable shareholder would consider important in deciding how to vote on the merger, such as the effect of the merger, the directors' material interests in the merger, the value of the shareholders' interests in the company, or the value of the merger consideration, particularly where the consideration consists of securities in another company. Inadequate disclosure would result in the resolution itself, even if adopted by the company, being flawed. The appropriate remedy would therefore be to set the transaction aside and to provide relief to all the shareholders generally.

Similarly, where there is a conflict of interest, for instance where the directors were self-interested in the merger and stood to gain unfairly from it, they may not have negotiated the best price for the shareholders. It would be appropriate in such circumstances to set aside the transaction. The same would apply where the vote on the merger resolution failed to comply with the statutory requirements. It is likely that fraud and material misrepresentation would also fall within this ground. An application based on this ground

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<sup>303</sup> See par 11; see also par 3.2 which introduced the exceptional requirement of court approval.

<sup>304</sup> See in this regard the present SRP Code supra note 84, General Principle 4 and Rule 20.2.

would in general promote efficiency and would also serve to monitor misconduct by the directors.

Turning to cl 119(6)(a), the interpretation of the ground for setting aside a resolution where it is manifestly unfair to a class of shareholders likewise remains to be seen. It appears to be quite narrowly worded. Firstly, it applies only in the event of unfairness to a ‘class’ – as opposed to an interest group – of shareholders. This would imply that minority shareholders generally may not be able to rely on the unfairness of a resolution that is unfair only in relation to the minority shareholders of a particular *class* of shares. Secondly, this ground of review is further restricted by the requirement of ‘manifest’ unfairness. Thirdly, the type of ‘unfairness’ that would suffice for the purposes of this remedy may either be restricted to procedural unfairness, or may alternatively and preferably be interpreted more widely to include unfairness on the merits or substance of the transaction and particularly unfairness of the price or merger consideration. An example would be where the directors receive fully-disclosed but over generous side-payments from the acquiring company as an inducement to secure their co-operation to the merger, at the expense of the shareholders of the target company.<sup>305</sup>

It may well be that, particularly where a large majority of the shareholders approves of the transaction after full and proper disclosure, a court would be reluctant to examine the substantive fairness or merits of the merger, on the basis that it is not for the courts to judge the merits of the transaction. But in view of the no-appraisal threshold which denies the minority shareholders the usual resort of opting out of the company through the exercise of the appraisal remedy, it is arguable that the ‘unfairness’ in terms of cl 119(6)(a) should be interpreted to encompass unfairness of price, in order to provide a remedy in these circumstances to a shareholder who is dissatisfied over the adequacy of the merger consideration.<sup>306</sup>

## 15.2 The Relationship between Clause 119(6) Court Approval and the Oppression Remedy

It is unclear whether dissenting shareholders in a merger under the Companies Bill could have alternative recourse to the oppression remedy provided by cl 164 of the Bill. Certainly in Canadian law,<sup>307</sup> in addition to

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<sup>305</sup> See Clark op cit note 16 at 457 and 465.

<sup>306</sup> However, it could well be that such a disgruntled shareholder would also have to raise some other ground of alleged wrongdoing in order to succeed in a claim of inadequate consideration under cl 119(6). This may be contrasted with the appraisal remedy which is a safeguard against inadequate consideration that operates on a no-fault basis, under which no wrongdoing need be alleged or proved. The restrictive wording in cl 119(6) of this ground is regrettable.

<sup>307</sup> It is interesting that under the previous Canada Corporations Act, 1970 (c C-32), the amalgamation provision gave shareholders holding at least ten per cent of the shares of any class, who had voted against the merger resolution, to apply to court for an order annulling the merger agreement: see s 137(5). Under this provision, dissenting shareholders did *not* have appraisal rights. The current Canadian legislation, Canada Business Corporations Act, 1985, now implements a different approach: shareholders now have appraisal rights, but no right of annulment as they had under the 1970 Act.

appraisal, a dissenting shareholder may rely on the oppression remedy<sup>308</sup> for a court application in connection with conduct by a company that is oppressive to or unfairly prejudicial to or unfairly disregards its interests.<sup>309</sup> Canadian courts have wide powers to intervene and make any suitable order, including restraining the conduct of the company, varying or setting aside the transaction, or even ordering compensation for the oppressed person.

This is especially significant since the oppression remedy under cl 164 of the Companies Bill is substantially similar in wording to the widely phrased oppression remedy under the Canadian legislation. It may thus be quite possible for dissenting shareholders to seek a remedy based on cl 164 of the Bill.

However, since cl 119(6) of the Bill states that the court may set aside a merger resolution *only* if one of the grounds specified in that section has been satisfied, the court may be precluded from relying on the oppression remedy in cl 164 as a basis for *setting aside* a merger resolution. It may nonetheless be possible for the court to grant *some other remedy* to the dissenting shareholder in terms of cl 164, such as compensation or restoration of the consideration that the shareholder had paid for the shares or other equivalent value, other than setting aside the merger resolution.

The grounds under cl 164 are, significantly, widely worded. Unlike cl 119(6), cl 164 is not restricted by any requirement of ‘manifest’ unfairness in relation to any particular ‘class’ of shareholders. Clause 164 therefore gives much more scope for an appropriate remedy for shareholders. Indeed, in Canada the equivalent provision on the oppression remedy is generally interpreted liberally and is widely relied on by dissatisfied shareholders.<sup>310</sup>

Similarly, in New Zealand shareholders or creditors who believe that they would be unfairly prejudiced by an amalgamation have the right to apply to court at any time before it takes effect and the court has an unrestrained discretion to make any order in relation to the proposal including modifying it, directing that it be reconsidered, or directing that no effect be given to it.<sup>311</sup> This remedy applies in addition to the usual buy-out right of dissenting shareholders in an amalgamation.

Both Canadian and New Zealand corporate law therefore make very effective provision for a court to come to the assistance of an unfairly prejudiced shareholder in a merger, with a wide discretion to make an appropriate order. It is to be hoped that South African courts will follow the same course by permitting disgruntled shareholders in a merger to rely on the

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Importantly, however, under the current Canadian legislation shareholders may rely on the oppression remedy to have the transaction set aside.

<sup>308</sup> See s 241 of the Canada Business Corporations Act, 1985.

<sup>309</sup> See Welling op cit note 259 at 578-9; Timothy S Chubb [of Stikeman Elliott LLP, Toronto] ‘To Be, or Not To Be: Going Private’, available at <http://www.stikeman.com> (last visited on 30 May 2007).

<sup>310</sup> See, eg, *Eiserman v Ara Farms Ltd* (1987) 52 DLR (4th) 498 (Sask CA); *First Edmonton Place v 315888 Alberta Ltd* (1988) 60 Alta LR 122 (Alta QB); Mark Gillen ‘Shareholder Remedies’, available at <http://www.law.uvic.ca/mgillen/315/documents/Ch26-ShareholderRemedies.pdf> (last visited on 30 May 2007) at 403-4.

<sup>311</sup> See s 226 of the New Zealand Companies Act, 1993.

oppression remedy, as opposed to restricting them to a reliance on cl 119(3)-(6). It is submitted that the oppression remedy ought rather to be considered as an additional remedy supplementing the court approval provisions.

## 16 Conclusion

The adoption of the statutory merger in South African law marks a substantial liberalisation in legislative policy. In terms of it, companies will soon be able to merge simply by way of a merger agreement supported by the prescribed majority of shareholders, without any requirement in general for the court approval of the merger. It represents a radical policy shift which is intended to harmonise South African law with American law, and which departs from its traditional leaning towards English company law. The previously shielded value of the importance of the individual shareholder's right to retain his shares in a company is to be de-emphasised, and the spotlight will fall on the facilitation of fundamental transactions coupled with a balancing of the collective interests of all the shareholders in a company.<sup>312</sup>

Not only is the statutory merger a progressive and modernised procedure, it is also a simple and efficient mechanism that would undoubtedly facilitate fundamental transactions, so assisting companies to adapt to changing conditions in the modern business world, in the interests of economic growth and wealth creation. The global market for mergers and acquisitions is buoyant. The total deal-value reached an all-time high in 2006 of USD3.4 trillion, and looks set to reach even higher values in 2007.<sup>313</sup> Predictions are that in 2008 the market will exceed USD5 trillion.<sup>314</sup> The prospects of mergers and acquisitions activity in South Africa are similarly optimistic and the South African market may be expected to take its lead from the heightened global markets.<sup>315</sup> Commendably, the statutory merger is an additional mechanism to, and not a replacement of, the already existing methods for companies wanting to effect business combinations and fundamental transactions, thus providing companies with a further very useful option. A widening of the range of options available to companies would also serve to accommodate differing circumstances, motivations and needs for fundamental transactions and business combinations.

The Bill is progressive in relation to the types and structures of mergers which it permits. Instead of restricting mergers merely to the traditional

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<sup>312</sup> See par 4 above.

<sup>313</sup> See Ambereen Chaudhury 'Global M & A Action Hits \$2 Trillion' 16 May 2007 *Business Report* at 1; Loraine Tulleken 'Ernst & Young Mergers & Acquisitions 2006' 25 May 2007 *Business Report Company News* at 9; Loraine Tulleken 'Buoyant Market and Regulatory Changes will Shape BEE Landscape' 25 May 2007 *Business Report Company News* at 13.

<sup>314</sup> See Loraine Tulleken 'Global M & A to Smash through \$5 Trillion Ceiling' 25 May 2007 *Business Report Company News* at 13.

<sup>315</sup> See Loraine Tulleken 'Ernst & Young Mergers & Acquisitions 2006' 25 May 2007 *Business Report Company News* at 9.

pooling-type transaction, the Bill also envisages cash mergers and apparently even triangular mergers. Thus, unlike several other jurisdictions, the Bill keeps up with the modern and liberal trends in America, as also adopted in Canada and New Zealand. It is surprising and most disappointing, though, that the Bill fails to provide for an abbreviated short-form merger procedure which would simplify mergers between holding companies and their wholly-owned subsidiaries and those between wholly-owned subsidiaries of the same holding company.<sup>316</sup>

The liberalisation in merger policy under the Companies Bill is counterbalanced or offset by the grant of appraisal rights to dissenting shareholders, who would have the right to opt out of the company by withdrawing the fair value of their shares in cash through the exercise of their appraisal rights. Dissenters generally would have no legal basis to prevent a merger that has received the approval of the requisite shareholder majority, except in certain limited circumstances where court approval of the merger is required.<sup>317</sup> The regulatory focus accordingly would now be on maintaining the correct equilibrium between the majority shareholders and the minority shareholders in order to prevent, on the one hand, minority oppression by the majority and, on the other hand, minority dictation by a recalcitrant minority.

In this regard, it is submitted that the balance attained by the Bill is somewhat skewed, being heavily weighted against the minority shareholders and in favour of the majority and the company. Not only is the prescribed shareholder approval threshold strikingly lenient and permissive,<sup>318</sup> as is the quorum for the shareholders' meeting in respect of the merger resolution,<sup>319</sup> but in addition the no-appraisal threshold which denies appraisal rights to disgruntled shareholders in certain circumstances is manifestly inappropriate, being out of keeping with the very justification and purpose of the appraisal right and worse, it opens the door to abuse of the minority.<sup>320</sup> It is accordingly submitted<sup>321</sup> that a more appropriate balance between the rights of the majority and the minority shareholders would result from increasing the prescribed shareholder approval threshold to a special majority of 75 per cent of the shares voted, coupled with an increased quorum of 50 per cent, and the abolition of the no-appraisal threshold. This would to a great extent deter unfairness to the minority, without being unduly burdensome or prohibitive of mergers.

Somewhat paradoxically, in the context of interested mergers (as opposed to arms' length mergers) and triangular mergers, the Bill implements strong minority protection measures that are unique to the South African legislation. A majority-of-minority-voting provision applies in the case of interested

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<sup>316</sup> See par 10 above.

<sup>317</sup> See pars 3.2 and 15 above.

<sup>318</sup> See par 3.1 above.

<sup>319</sup> *Ibid.*

<sup>320</sup> See par 12 above.

<sup>321</sup> See pars 3.1 and 12 above.

mergers, according to which a shareholder who stands on both sides of a merger transaction is precluded from voting its shares in the target company in respect of the merger resolution, so preventing abuse of the freeze-out merger procedure.<sup>322</sup> This is a commendable and forward-looking provision. But the (implicitly) extended application of this provision to the two-step merger mechanism requires closer consideration.<sup>323</sup> In the context of triangular mergers, the Bill apparently requires not only the approval of the shareholders of the two merging companies, but also the approval of the shareholders of the holding company of the acquirer/wholly-owned subsidiary acquisition vehicle.<sup>324</sup> This requirement effectively cancels one of the main advantages enjoyed by merging companies in America and Canada in triangular mergers, in favour of safeguarding the interests of the shareholders of the holding company. As such, this provision of the Bill gives prime recognition to the substance, as opposed to the form, of the triangular merger transaction.

As the leading remedy for dissenting shareholders in a merger, the effectiveness of appraisal is with respect much diminished by its procedural flaws.<sup>325</sup> The appraisal procedure as laid down in the Bill is much too complex, technical and rigid for shareholders, and it is associated with burdensome delays and prohibitive costs, so that the scales are once again tilted in favour of the company. The amendments proposed would remove these procedural flaws and render appraisal a much more useful remedy for disgruntled shareholders, without imposing too unreasonable a burden on the company. With regard to the method of valuation of shares in the appraisal context, our courts, in a similar vein to Canadian and New Zealand courts, would have useful resort to the richly developed and long-standing judicial experience of the Delaware courts on appraisal-valuation methodology.<sup>326</sup>

In conclusion, notwithstanding the above submissions and criticisms, the introduction of the statutory merger in South African law is a most welcome and commendable move, one likely to launch an exciting new era in South African company law relating to fundamental transactions.

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<sup>322</sup> See par 8 above.

<sup>323</sup> See par 9 above.

<sup>324</sup> See par 6 above.

<sup>325</sup> See par 13 above.

<sup>326</sup> See par 14.