

**The protection of shareholders and creditors in the context of  
takeovers and reorganisations under the Companies Act 71 of  
2008**

by

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## ABSTRACT

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Empirical research in the previous years has shown the history and the evolution of takeovers and mergers in South Africa. Many theories have emerged to show the advancement in the Companies Act 71 of 2008 (the new Act) from the old Companies Act 61 of 1973 especially on issues relating to takeovers and reorganisations. These include measures in the new Act that are designed to protect shareholders and creditors in the context of takeovers.

Cassim and several other writers have provided insight into the changes brought about by the new Act with regards to the protection of shareholders and creditors. This research identifies the strengths and weaknesses of the measures introduced in the new Companies Act 71 of 2008 which protect the shareholders and creditors in the context of mergers and takeovers. This will be done through a critical analysis of the shareholder and creditor protective measures contained in the new Act and a comparative analysis of the takeover regulations in South Africa, the United States of America and the United Kingdom.

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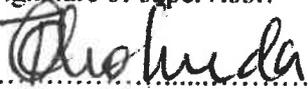
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# CHAPTER ONE

## GENERAL INTRODUCTION

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### 1.1 BACKGROUND.

The abolishment of the Companies Act 61 of 1973 by the Companies Act 71 of 2008 (the new Act) was an attempt to *inter alia* align South African law with international best practices, to promote company efficiency by reforming the mergers and takeover regime so that the law facilitates the creation of business combinations, to encourage transparency so to protect shareholder rights and to provide a predictable and effective regulatory environment.<sup>1</sup> Some of the provisions of the Companies Act 61 of 1973 no longer accords with modern business practices.

In the pursuit of the above objectives the Department of Trade and Industry (the DTI) in 2004 published the document ‘South African Company Law for the 21<sup>st</sup> Century: A guideline for Corporate Law Reform’ (the DTI policy document). This document details the rationale for, and the objectives of the company law reform process. On the basis of there being a need to accommodate the environment of business that is forever changing and to alter our law to be in line with international trends.<sup>2</sup>

The DTI policy document states that when one considers the vision of the economy and the challenges that South Africa is facing, company law should promote the development of the South African economy and promote the economy’s competitiveness by:

- ‘Encouraging entrepreneurship and enterprise diversity by simplifying the formation of companies and reducing costs associated with the formalities of forming a company and maintaining its existence, thereby contributing to the creation of employment opportunities;

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<sup>1</sup> The Department of Trade and Industry n2 3–4.

<sup>2</sup> DTI policy document 5.

- Promoting innovation and investment in South African markets and companies by providing a predictable and effective regulatory environment and flexibility in the formation and the management of companies;
- Promoting the efficiency of companies and their management;
- Encouraging transparency and high standards of corporate governance, recognising the broader social role of enterprises;
- Ensuring compatibility and harmonisation with best practice jurisdictions internationally.<sup>3</sup>

Therefore, the role of the new Act has extended from not only regulating the relations between the shareholders and directors of a company, to encompass the promotion of development and the competitiveness of the South African economy. According to the DTI policy document, the primary objective of the takeover provisions in the new Act is to ensure there is integrity in the market and that the interests of various parties that are affected in a takeover bid are protected.<sup>4</sup> These takeover provisions are the subject of this study.

## 1.2. INTRODUCTION.

A takeover can be effected through various takeover techniques and offers that are prescribed in the new Act. Some of these takeover techniques are classified as fundamental transactions. These fundamental transactions are the disposal of all or a greater part of the assets of the company or undertaking,<sup>5</sup> mergers and amalgamations<sup>6</sup> and schemes of arrangement.<sup>7</sup> Definitions of each of the fundamental transactions follow below.

The disposal of all or a greater part of the assets of a company entails a company selling all or a greater part of its assets. As to what constitutes ‘all or a greater part of the assets of a company or undertaking of a company’ the new Act starts by defining the assets of the company as more than 50 per cent of the gross assets of a company fairly valued irrespective of its liabilities. With regards to a company’s undertaking the new Act determines that this refers to more than 50 per cent of the value of the company’s entire undertaking which is fairly valued.<sup>8</sup>

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<sup>3</sup> DTI policy document 11.

<sup>4</sup> DTI policy document 40.

<sup>5</sup> S 112 of the new Act.

<sup>6</sup> S 113 of the new Act.

<sup>7</sup> S 114 of the new Act.

<sup>8</sup> S 1 of the new Act.

Section 1 of the new Act describes a ‘merger’ or ‘amalgamation’ as:

‘A transaction, or series of transactions, pursuant to an agreement between two or more companies, resulting in-

- the formation of one or more new companies, which together hold all the assets and liabilities that were held by any of the amalgamating or merging companies immediately before the implementation of the agreement, and the dissolution of each of the amalgamating or merging companies, or
- the survival of at least one of the amalgamating or merging companies, with or without the formation of one or more new companies, and the vesting in the surviving company or companies, together with such new companies, of all of the assets and liabilities that were held by any of the amalgamating or merging companies.’<sup>9</sup>

A scheme of arrangement is a transaction whereby the board of directors of a company proposes that the company and its shareholders enter into an agreement to make an arrangement in respect of the company’s securities.<sup>10</sup> The arrangement can be a reorganisation of the company’s securities. This may be achieved in various ways: it can be through the consolidation of securities that are from different classes, could be through an expropriation of the company’s securities from the holder of those securities or a reacquisition by the company of its securities, could be a division of these securities into different classes, could be an exchange of securities for other securities and it could be a combination of all these different ways in which the reorganisation of securities can take place.<sup>11</sup> The scheme of arrangement is classified as the more flexible procedure that can be used in effecting a takeover and continues to be an efficient and common method for carrying out takeovers and reorganisations that are successful.<sup>12</sup>

There is always the danger of prejudice against shareholders and creditors when a company enters into a fundamental transaction agreement. For example two companies enter into an agreement to merge and form a single new company. One of the shareholders of one of the merging companies does not want to be part of the newly formed company and wants to exit.

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<sup>9</sup> *Ibid.*

<sup>10</sup> S 114 of the new Act.

<sup>11</sup> S 114(1) of the new Act.

<sup>12</sup> Latsky J ‘The fundamental transactions under the Companies Act: a report back from practice after five years’ (2014) *Stellenbosch Law Review* 372.

As a result of wanting to exit the shareholder suffers prejudice because he is offered an unfair market value for his shares by the company. Another example would be where a company enters into a fundamental transaction agreement to dispose all of its assets. The creditors of that company suffer prejudice because there is no residual value that they can make their claims against. These are not the only instances where shareholders and creditors can suffer prejudice. It is for these reasons and others that it becomes important that the new Act protects shareholders and creditors in the context of fundamental transactions.

### 1.3. **RESEARCH PROBLEM.**

The DTI policy document which was issued in 2004 stated that the primary objective of the takeover bid provisions in the new Act is to ensure that the rights and interests of various parties in a takeover bid are adequately protected.<sup>13</sup> The purpose of this research is to identify the strengths and weaknesses of the measures introduced in the new Act which protect the shareholders and creditors of a company that is involved in a takeover.

### 1.4. **RESEARCH QUESTIONS.**

- What measures have been introduced in order to protect minority shareholders who may be prejudiced by the majority?
- What strengths and weaknesses can be identified in so far as the protection of minority shareholders are concerned?
- Are the protective measures included in the new Act aligned with international trends?

### 1.5. **RESEARCH METHODOLOGY.**

The purpose is to compare the protection in South African law with the law in the United States of America and the law in the United Kingdom, and in so doing identify strengths and weaknesses in the South African framework. Moreover, the aim is to indicate how South African law in this context measures up with international trends. The comparison with the United States of America is influenced by the fact that the new Act is drafted with reference to some but not all principles of American company law.<sup>14</sup> The comparison in regards to the United Kingdom is motivated by the fact that South African law was influenced by English

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<sup>13</sup> The DTI policy document 40.

<sup>14</sup> Boardman N 'A critical analysis of the new South African takeover laws as proposed under the Act' (2010) *Acta Juridica* 306-307.

law, traces of the latter can still be found in our law.<sup>15</sup> Published articles, journals, textbooks and case law are used.

## 1.6. **STRUCTURE OF THE RESEARCH.**

Chapter 1 is the introductory chapter that contains the background to the study, research problem and questions, research methodology and the structure of the research.

Chapter 2 is an assessment of the protective measures in the new Act in relation to the shareholders of the company in the context of takeovers and reorganisations.

Chapter 3 is an assessment of the protective measures in the new Act in relation to the creditors of the company in the context of takeovers and reorganisations.

Chapter 4 is a comparative analysis of protective measures in respect of shareholders and creditors of the company in South Africa with the protective measures in the United States of America and the United Kingdom.

Chapter 5 are the main conclusions drawn from the analysis and puts forward recommendations for improvement in this area that are considered necessary.

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<sup>15</sup> The DTI policy document 14.

## CHAPTER TWO

# PROTECTION OF SHAREHOLDERS

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### 2.1 INTRODUCTION.

It is important that the new Act protects shareholders when a company engages in an affected transaction<sup>16</sup> because they may be prejudiced by being treated unfairly. In general it is conceivable that if the Act did not provide protection the following are of a few of the examples that could arise. Example -A- when two companies enter into a merger agreement and there will be only one surviving company. Some of the shareholders of the disappearing company do not wish to hold shares in the surviving company. Assuming that there is no way out for these shareholders they will be prejudiced by being compelled to hold shares in the surviving company despite their wishes.<sup>17</sup> Example -B- when three companies enter into a merger agreement to form one new company. The shareholders of one of the merging companies do not wish to hold shares in the newly formed company. Assuming that there is a way out for the dissenting shareholders they suffer prejudice by being offered an unfair market value of their shares as an exit option. Example -C- when a company engages into a scheme of arrangement through inadequate disclosure and material procedural irregularity and there is a division of securities into different classes. As a result the shares of minority shareholders become non-voting ordinary shares and the shares of the majority become preference shares. Assuming that there is no remedy for this conduct the minority shareholders suffer the prejudice of receiving shares of an inferior precedence to those of the majority through procedural irregularity.

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<sup>16</sup> An affected transaction in respect of the provisions of the Companies Act 71 of 2008 under s 117 is defined as:  
'(i) a transaction or series of transactions amounting to the disposal of all or the greater part of the assets or undertaking of a regulated company, as contemplated in section 112, subject to section 118(3);  
(ii) an amalgamation or merger, as contemplated in section 113, if it involves at least one regulated company, subject to section 118(3);  
(iii) a scheme of arrangement between a regulated company and its shareholders, as contemplated in section 114, subject to section 118(3);  
(iv) the acquisition of, or announced intention to acquire, a beneficial interest in any voting securities of a regulated company to the extent and in the circumstances contemplated in section 122(1);  
(v) the announced intention to acquire a beneficial interest in the remaining voting securities of a regulated company not already held by a person or persons acting in concert;  
(vi) a mandatory offer contemplated in section 123; or  
(vii) compulsory acquisition contemplated in section 124;'

<sup>17</sup> Bainbridge *SM Corporation Law and Economics* (2002) 632.

Example -D- is the case of *Justpoint Nominees (Pty) Ltd and Others v Sovereign Food Investments Limited and Others (BNS Nominees (Pty) Ltd and Others Intervening)*.<sup>18</sup> Sovereign Food Investments Limited (S) as a shareholder in Justpoint Nominees [Pty] Ltd (J) proposed to repurchase its own shares in the company J. This is transaction that required a special resolution in order to be adopted. Some shareholders in J were against the transaction and demanded a fair market value of their shares to exit the company. This resulted in more shareholders in J being against this transaction totalling in more than five per cent of J's shareholders opposing this transaction. The transaction documents had applicable rules which stated that if five percent or more of J's shareholders are against a proposed transaction it has to be abandoned. S revised the transaction so that it does not fall within the ambit of the Act and the applicable rules. It sought to exclude J's dissenting shareholders not to vote in the revised transaction since they demanded a fair market value of their shares and losing all rights that are attached to these shares. J approached the court and it was held that S's conduct was prejudicial towards J's shareholders by not allowing them to vote in the revised transaction.

## 2.2. THE TAKEOVER REGULATION PANEL.

The Takeover Regulation Panel regulates any affected transaction or offer that applies to a company in accordance with Part B, Part C and the takeover regulations in the new Act. The company spoken of is a profit company<sup>19</sup> which may be a public company,<sup>20</sup> a state owned company unless exempted in terms of section 9,<sup>21</sup> a private company but only if a specific percentage of the issued securities of that company have been transferred within a period of twelve months immediately before the date of a particular affected transaction or the offer exceeds the prescribed percentage spoken about in section 2 of the new Act or the company's memorandum of incorporation expressly provides that the company and the company's securities fall under the takeover regulations.<sup>22</sup>

Section 119 of the Act empowers the Takeover Regulation Panel to regulate any affected transaction. The main objectives of the new Act in empowering the Takeover Regulation Panel to regulate affected transactions is to:

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<sup>18</sup> <http://www.saflii.org/za/cases/ZAECPEHC/2016/15.html> (unreported case) (accessed on 09/04/18).

<sup>19</sup> S 118(1).

<sup>20</sup> S 118(1)(a).

<sup>21</sup> S 118(1)(b).

<sup>22</sup> S 118(c).

- ensures fairness to shareholders,<sup>23</sup>
- ensure that necessary information is provided to the shareholders timeously in order to make an informed decision,<sup>24</sup>
- ensure that all the shareholders of a company are treated fairly and equally,<sup>25</sup>
- ensure that all the shareholders of a company receive same information,<sup>26</sup>
- ensure that no relevant information is withheld from the shareholders of a company.<sup>27</sup>

The powers that are conferred by the new Act on the Takeover Regulation Panel are that the latter can:

- require that a specific document in respect of an affected transaction or offer be filed for approval,<sup>28</sup>
- consult with any relevant person with the view of advising that relevant person on the application of the new Act and regulations that apply to takeovers,<sup>29</sup>
- deal with any representations of parties on any matter in respect of affected transactions or offers,<sup>30</sup>
- issue a compliance notice or a compliance certificate,<sup>31</sup>
- amend policy guidelines dealing with affected transactions.<sup>32</sup>

The conclusion seems to be that the provisions under section 119 conferring regulatory powers on the Takeover Regulation Panel serve as protective measures in favour of the shareholder. Section 170 makes these provisions effective as the Takeover Regulation Panel can initiate legal proceedings in the name of a shareholder<sup>33</sup> and even refer a matter to the National Prosecuting Authority if there is an offence that has been committed.<sup>34</sup>

There are cases that enshrine the regulations under section 119 which the Takeover Regulation Panel has ruled on. For example, in the case of *Beige Holdings Limited v Lion Match Company*

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<sup>23</sup> S 119(1)(a).

<sup>24</sup> S 119(1)(b).

<sup>25</sup> S 119(2)(b)(i).

<sup>26</sup> S 119(2)(d).

<sup>27</sup> S 119(2)(c).

<sup>28</sup> S 119(4)(a).

<sup>29</sup> S 201(2)(a) of the new Act.

<sup>30</sup> S 201(2)(c).

<sup>31</sup> S 119(4)(c).

<sup>32</sup> S 201(2)(b).

<sup>33</sup> S 170(1)(e).

<sup>34</sup> S 170(1)(f).

*(Proprietary) Limited*,<sup>35</sup> Lion (L) made an offer to acquire shares from Beige (B) and this offer was going to result in L being able to exercise more than thirty five per cent of the voting rights in B. L also wanted to acquire the different classes of shares at lower prices and others at higher prices and this meant that some of B's shareholders will be unfairly treated. The Takeover Regulation Panel ruled that in order to ensure fairness to the shareholders in terms of section 119(1)(a) of the new Act and to ensure that all shareholders are treated equally and fairly as stated under section 119(2)(b) (i) of the new Act. L must make a comparable offer to all the holders of different classes of securities in reference to section 125(2) of the Act and regulation 87.<sup>36</sup>

In the case of *Remgro Ltd and Mediclinic International Limited and Al Noor Hospitals Group PLC*,<sup>37</sup> the dispute was whether the shareholders of a holding company could vote in passing of a special resolution for a scheme of arrangement involving its subsidiary. This matter was brought before the Takeover Regulation Panel because the shareholders in the holding company felt unfairly treated when they were not allowed to vote regarding the proposed scheme of arrangement. The Takeover Regulation Panel with the powers conferred upon it by the Act ruled that the holding company is allowed to vote regarding the scheme of arrangement. The reason for this because it is in line with section 119(1)(a) of the new Act that states that the Takeover Regulation Panel must ensure fairness to all shareholders. Also, section 119(2)(b) (i) of the new Act states that the Takeover Regulation Panel must ensure that all shareholders are treated equally and fairly.

There are other shareholder protective measures found in the new Act in relation to affected transactions or takeover techniques<sup>38</sup> apart from those afforded by the Takeover Regulation Panel. These are shareholder approval in terms of section 112(2)(a),<sup>39</sup> 113(4)(b)<sup>40</sup> and 114(1)<sup>41</sup> that refers to section 115,<sup>42</sup> also the power given to shareholders to ask for a court review of the fundamental transactions in terms of section 115, also the power invested in shareholders

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<sup>35</sup> [http://www.trpanel.co.za/wpcontent/uploads/PDFs/Beige\\_Holdings\\_Limited\\_and\\_Lion\\_Match\\_Company\\_Proprietary\\_Limited.pdf](http://www.trpanel.co.za/wpcontent/uploads/PDFs/Beige_Holdings_Limited_and_Lion_Match_Company_Proprietary_Limited.pdf) (accessed 09/04/18).

<sup>36</sup> Companies Regulations of 2011.

<sup>37</sup> <http://trpanel.co.za/wp-content/uploads/2016/07/Remgro-Ltd-Mediclinic-International-Ltd-Al-Noor-Hospitals-Group-Plc-Ruling.pdf> (accessed 09/04/18).

<sup>38</sup> Cassim F, Cassim MF, Cassim R, Jooste R, Shev J, Yeats J n48 700-735.

<sup>39</sup> S 112(2)(a) of the new Act.

<sup>40</sup> S 113(4)(b).

<sup>41</sup> S 114(1).

<sup>42</sup> S 115.

to ask for a fair value of their shares by appraisal remedy in terms of section 164<sup>43</sup> and the oppression remedy in terms of section 163.<sup>44</sup> These shareholder protective measures are discussed in detail below.

### 2.3.1. **APPRAISAL RIGHT.**

Section 164 of the new Act provides for an appraisal right as a protective measure in favour of shareholders who are opposed to a proposed fundamental transaction.<sup>45</sup> These dissenting shareholders are required to send a notice of objection before the special resolution is adopted and they must have voted against this resolution.<sup>46</sup> Eventually when the resolution is adopted, the shareholders may demand a fair value of their securities in the company. The board of directors in the company must make an offer to the dissenting shareholders and if the shareholders feel that the offer is not a fair market value of their securities they can apply to the court for a fair valuation of their securities.<sup>47</sup> In reference to example -A- as provided in the introductory paragraph of this chapter. The appraisal remedy provides a way out for a shareholder who does not want to be compelled to accept shares in a company that he does not want to be a part of. Similarly to the instance provided in example -B- a dissenting shareholder can utilise the appraisal right to challenge the offer made for his shares. If he feels that the offer made is not a fair market value of his shares.

It seems clear that the appraisal remedy is effective in protecting the rights of the shareholders by creating a way out for shareholders who do not want to be trapped in a transaction that they do not want to be a part of, but this effectiveness is hampered by some factors. For one the appraisal remedy is skewed in favour of the company as opposed to the shareholder because it is complex and if the dissenting shareholder misses a step he loses this right.<sup>48</sup> The protective measure is also found to be costly and expensive as the shareholder will have to get legal advice. If a shareholder in good faith approaches the court for evaluation, the court can make an order of costs against the shareholder. The court has a discretion to make an order as to what is the fair market value of the securities and which may be unfavourable to the shareholder.<sup>49</sup>

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<sup>43</sup> S 164.

<sup>44</sup> S 163.

<sup>45</sup> S 164.

<sup>46</sup> *Ibid.*

<sup>47</sup> S 164.

<sup>48</sup> Cassim *et al Contemporary Company Law* (2012) 807–808.

<sup>49</sup> *Ibid.*

This is criticised as the market value is not an automatic method of valuation since in many cases it is not reflective of the true worth of the company.

The courts in the United States of America have a broad understanding and experience when it comes to the interpretation of 'fair value' and the appraisal evaluation method. They have Delaware courts that specialise in valuation.<sup>50</sup> Also, when a shareholder uses his appraisal rights in respect of a fundamental transaction he loses all his rights that are attached to his shares in the company.<sup>51</sup> In South Africa payment in respect of the fair market value of shares is made to a shareholder at the end of a dispute.<sup>52</sup> In contradistinction a company is required to make a provisional payment in respect of the fair market value at an early stage and the rest at the end of the fair market value dispute in New Zealand.<sup>53</sup> Therefore, the New Zealand approach is the best approach to be followed as it gives the shareholder immediate use of funds by merely allowing that a provisional payment in respect of the fair market value of his shares be made. This is opposed to the South African approach which deprives the use of funds by the shareholder until the end of the dispute.<sup>54</sup>

### 2.3.2. **OPPRESSION REMEDY.**

Section 163 of the new Act provides that a director / shareholder of a company may apply to the court for relief if:

- 'a) any act or omission of the company, or a related person, has had a result that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of, the applicant;
  - b) the business of the company, or a related person, is being or has been carried on or conducted in a manner that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of, the applicant; or
  - c) the powers of a director or prescribed officer of the company, or a person related to the company, are being or have been exercised in a manner that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of, the applicant.'
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<sup>50</sup> Cassim MF 'The Introduction of the Statutory Merger in South African Corporate Law: Majority Rule Offset by the Appraisal Right (Part 2)' (2008) 20 *SA Merc LJ* 169-170.

<sup>51</sup> *Ibid* 165.

<sup>52</sup> Cassim n50 165-167.

<sup>53</sup> S 112(4) of the New Zealand Companies Act of 1993.

<sup>54</sup> Cassim n50 165-167.

<sup>55</sup> S 163 of the new Act.

After careful consideration of an application the court may make an interim or final order to rectify the unfair actions.<sup>56</sup> In reference to example -D- of my introduction the oppression remedy can rectify the prejudicial conduct of excluding shareholders from voting in a revised transaction.

The oppression remedy is somehow better than the appraisal remedy because it is not as complex and it is easier to execute than the appraisal remedy. For the reason that with the appraisal remedy if the dissenting shareholder fails to send a notice of objection before the special resolution is adopted or fails to vote against a resolution he loses the appraisal right. In contradistinction a shareholder only has to be unfairly prejudiced to make an application to the court with the oppression remedy. Nevertheless, the oppression remedy can be time consuming as leave to apply has to be filed first before the initial application is made. This remedy can also be costly if the application is not successful it is most likely that the court will make an order of costs against the applicant and this makes it an unpopular form of protection for the shareholders.<sup>57</sup> However, apart from the flaws pointed out the oppression remedy is a far better remedy than the court review procedure remedy found under section 115(2)(c) of the new Act. The reason for this is because the oppression remedy is available to any shareholder and not only to shareholders that have voted against a resolution as the court review procedure remedy requires. Also, the oppression remedy provides for a broad range of powers as the court upon considering an application it can make an order that it considers fit.<sup>58</sup> Including but not limited to restraining the conduct that is being complained about,<sup>59</sup> or directing a company or even a specific person with or without further conditions to restore to a shareholder any part of the consideration that the shareholder paid in for shares or pay the equivalent amount of what the shareholder paid in,<sup>60</sup> or set aside a fundamental transaction to which a company is a party to and that the company be compensated or any other party to the transaction,<sup>61</sup> or directing that compensation be paid to an aggrieved person if this is subject to any other law that entitles that specific person to be compensated.<sup>62</sup>

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<sup>56</sup> S 163(1) and (2).

<sup>57</sup> Davids E, Norwitz T and Yuill D 'A Microscopic analysis of the new merger and amalgamation provision in the Act' (2010) *Acta Juridica* 363.

<sup>58</sup> *Ibid.*

<sup>59</sup> S 163(2)(a) of the new Act.

<sup>60</sup> S 163(2)(g).

<sup>61</sup> S 163(2)(h).

<sup>62</sup> S 163 (2)(j) of the Act.

### 2.3.3. SHAREHOLDER APPROVAL.

Section 115(2) of the new Act provides a protective measure for shareholders in the context of fundamental transactions by requiring that a fundamental transaction must be approved by a special resolution passed by the shareholders at a meeting called for that purpose. Also, a quorum must be present in the meeting meaning an aggregate of at least twenty five per cent of voting rights must be present at the meeting.<sup>63</sup> The adoption of the special resolution is by a support of seventy five per cent of the voting rights.<sup>64</sup> If the shareholders of the company seek greater protection from a fundamental transaction they may make the quorum to become higher than twenty five per cent in the memorandum of incorporation.<sup>65</sup> This is a protective measure for shareholders of a holding company as a special resolution by shareholders of a holding company will be required for the disposal of all or a greater part of the assets or undertaking of a subsidiary company. Except from the subsidiary's shareholders because the latter constitutes a disposal of all or greater part of the assets or undertaking of the holding company.<sup>66</sup> Although the shareholders' approval requirement is a form of protection for the shareholders of a company. It can tend to compromise commercial opportunities afforded to a company due to the delays involved in getting approval from shareholders. The reason for this is that convening a meeting for the shareholders' approval can take time since a notice needs to be delivered to each shareholder of the company before fifteen days to the meeting.<sup>67</sup> Also, the memorandum of incorporation can only provide a higher minimum than the required fifteen days and not less,<sup>68</sup> and what could add more delay is the fact that any shareholder can apply to the court for an order setting aside a demand for a meeting.<sup>69</sup> This means that where there is an offer made to the company and considering the delays that come with getting the approval of shareholders for such a transaction the opportunity can be lost to other companies. Loss of opportunity equals loss of business, loss of business equals loss of profits affecting the company owners who are in turn shareholders.

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<sup>63</sup> S 115 (2) (a) of the Act.

<sup>64</sup> S 1 of the Act.

<sup>65</sup> Cassim *et al* n48 691.

<sup>66</sup> S 115(2)(a) and (b).

<sup>67</sup> S 62 (1) (a) of the Act.

<sup>68</sup> S 62 (2) of the Act.

<sup>69</sup> S 61(5) of the Act.

#### 2.3.4. COURT APPROVAL.

Section 115(3) of the new Act provides that a company may not proceed to implement a proposed transaction after a resolution unless it is approved by the court. That is an instance where the resolution was opposed by at least fifteen per cent of the voting rights and within five days of such opposing votes being made a shareholder requires the company to seek the court approval.<sup>70</sup> Also, where a shareholder who voted against the resolution in spite of a majority percentage in support of the resolution to adopt the proposed transaction makes an application for leave to apply for a review of the transaction within ten days of the voting. The court will grant leave should it be satisfied that the application is in good faith<sup>71</sup> and if the proposed resolution will be unfair to holders of any class of securities of the company.<sup>72</sup> Over and above that if the shareholder is prejudiced by the voting which was materially tainted by a conflict of interest, failure to comply with the Act, applicable rules of the company and material procedural irregularity.<sup>73</sup> Notwithstanding, the remedy is found to be costly and expensive as the shareholder will have to acquire legal advice in order to execute the court review procedure. Additionally, the effectiveness of this protective measure is hindered by the fact that it is a remedy that is not available to all shareholders of the company but only to those shareholders who have voted against the resolution of adopting a fundamental transaction.<sup>74</sup> In comparison to the position under the Companies Act 61 of 1973 (old Companies Act), the stand was that all shareholders were protected by the court approval requirement irrespective of having voted against or not voted against the resolution. This is because it was a requirement for all mergers to be approved by the court.<sup>75</sup> In as far as the court approval requirement in the new Act being a shareholder protective measure that addresses technicalities the traditional conservative approach of not having a statutory merger seems to be better. Conversely, the statutory merger procedure seems to be better in trying to find the appropriate balance of the interests of all the shareholders. So it can avoid minority dictation which makes it possible to prevent improved company management that can result from a merger or avoid the oppression of the minority by majority shareholders.<sup>76</sup>

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<sup>70</sup> S 115 (3) (a) of the new Act.

<sup>71</sup> S 115 (6) (a) of the new Act.

<sup>72</sup> S 115 (7) (a) of the new Act.

<sup>73</sup> S 115 (7) (b) of the new Act.

<sup>74</sup> Davids et al n57 363.

<sup>75</sup> Cassim 'The Introduction of the Statutory Merger in South African Corporate Law: Majority Rule Offset by the Appraisal Right (Part 1)' 2008 20 SA *Merc LJ* 22.

<sup>76</sup> *Ibid.*

## 2.4. TAKEOVER OFFERS.

A takeover offer is an action which is taken by an acquiring company that makes an offer to the shareholders of a target company to purchase their shares and this is done so to gain control of the target company. The Act provides several shareholder protective measures in relation to takeover offers.<sup>77</sup> These are mandatory offers in terms of section 123,<sup>78</sup> compulsory acquisition and squeeze out in terms of section 124,<sup>79</sup> comparable and partial offers in terms of regulation 86<sup>80</sup> and section 125,<sup>81</sup> and restrictions on frustrating action in terms of section 126.<sup>82</sup> These protective measures are discussed in detail below.

### 2.4.1 COMPULSORY ACQUISITION / SQUEEZE OUT.

Section 124<sup>83</sup> of the Act provides a protective mechanism for the shareholders of a company in striving to make sure that all the shareholders of a company are treated equally and fairly. Section 124 provides that if within 4 months from the date where an offer was made to acquire any class of securities of a regulated company and that offer was accepted by at least 90 per cent of the security holders.<sup>84</sup> Within a further two months the offeror will notify the holders of the remaining securities that he has acquired 90 per cent of the securities in a specific class and that he desires to acquire all of the remaining securities of that class.<sup>85</sup> After the offeror has given this notice he is entitled to acquire the securities based on the same terms and conditions that applied to the holders of the securities that accepted the original offer.<sup>86</sup> In as much as the offeror is entitled to acquire the remaining securities on the same terms and conditions that applied to the holders of the securities that accepted the original offer. The holders of the remaining securities are just as entitled to such terms and conditions.<sup>87</sup> Section 124(2) provides that any holder of the remaining securities within 30 days of receiving a notice from the offeror may apply for a court order that orders that the offeror is not entitled to acquire the remaining securities or impose different terms and conditions of acquisition.<sup>88</sup> The disadvantage here is that the Act is silent regarding grounds that can be used on the section 124 application and it is

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<sup>77</sup> Cassim et al n48 735-41.

<sup>78</sup> S 123 of the new Act.

<sup>79</sup> S 124.

<sup>80</sup> Regulation 86 of the Companies Regulations of 2011.

<sup>81</sup> S 125 of the Act.

<sup>82</sup> S 126 of the Act.

<sup>83</sup> S 124 of the Act.

<sup>84</sup> S 124(1) of the Act.

<sup>85</sup> S 124(1)(a) of the Act.

<sup>86</sup> S 124(1)(b).

<sup>87</sup> S 124(4) and (5).

<sup>88</sup> S 124(2) of the Act.

most likely that if the offer that is made is a fair offer then such an application will be unsuccessful.<sup>89</sup> Lastly, this measure comes at a cost because the shareholder has to seek legal assistance to make the application.

#### **2.4.2 A COMPARABLE AND PARTIAL OFFER.**

Section 125 of the new Act provides for a comparable offer which is aligned to shareholders of a company being treated fairly and equally as contemplated under section 119. It provides that when an offeror makes an offer for any securities of the company and this offer results in the offeror who is holding these securities to be entitled to exercise thirty five per cent of the voting rights. A comparable offer must be made for each class of issued securities of that company.<sup>90</sup> Similarly if a regulated company that has more than one class of issued securities happens to reacquire any class of its voting rights in terms of the scheme of arrangement. As a result that person(s) holds securities of the company, entitling him/them to exercise more than thirty five per cent of the voting rights. Then the person(s) must then make a comparable offer to each class of the issued securities of that company.<sup>91</sup> Section 125(3) is about an offer that is balanced with the need to treat all the shareholders of a company equally and basically to protect the interests of a minority. All the offerees must be treated equally when the offeror wants to acquire extra securities that have been tendered by the offerees, the offeror must acquire these securities *pro rata*.<sup>92</sup> Nonetheless, it is submitted that the rights of the minority are not protected at every single acquisition but they are only protected when an offer results in the offeror moving from a position of voting rights that is below to a position that is above the prescribed percentage or even acquiring hundred per cent of the voting rights. This is because regulation 88<sup>93</sup> exempts partial offers from compliance with the new Act and the regulations. The partial offer will be exempt if the offeror when making an offer tends to hold securities entitling him to exercise voting rights equal to or in the excess of the prescribed percentage.

#### **2.4.3 A MANDATORY OFFER.**

Section 123 of the Act<sup>94</sup> obliges an acquirer of the company's securities to make a mandatory offer to all the shareholders of a company but only if:

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<sup>89</sup> Delpont P and Vorster Q *Henochsberg on the Act* (2015) 434.

<sup>90</sup> S 125(2) of the Act.

<sup>91</sup> *Ibid.*

<sup>92</sup> Cassim et al n48 739.

<sup>93</sup> Regulation 88 of the Companies Regulations, 2011.

<sup>94</sup> S 123 of the Act.

- Regulated company reacquires voting securities in terms of a scheme of arrangement or as stated under section 48.<sup>95</sup>
- One person has acquired a substantial beneficial interest in the voting rights attached to securities issued by a regulated company. The latter will also apply to two or more person related/inter-related or two or more persons acting with the same objective.<sup>96</sup>
- Before an acquisition is made by this person or persons mentioned above, he/they were able to exercise less than thirty five per cent of the voting rights that are attached to the company's securities.<sup>97</sup>
- Now as a result of the acquisition along with the securities held before, he/they are now able to exercise at least thirty five per cent of the voting rights that are attached to the company's securities.<sup>98</sup>

This thirty five per cent threshold mentioned above is determined by the Minister and provides for a maximum of not more than thirty five per cent.<sup>99</sup> If it happens that more than thirty five per cent is acquired, the acquirer/s whom the voting rights vests is/are required to give out a notice to holders who hold the remaining securities in the company and this must be done within one day of acquisition. The very notice that is given must have a statement that says he/they are in a position to exercise at least thirty five per cent of the voting rights and this notice must make an offer to acquire the remaining securities.<sup>100</sup> Afterwards, within one month he/they must deliver a written offer to the holders of those securities.<sup>101</sup> This protective measure has its flaws apart from the fact that it protects shareholders from being bought out at a lower price than the initial price at which the acquirer bought the previous shareholders out for. This measure may cause the initial offer to fall out as an acquirer who only intended to acquire thirty five per cent of the shares may find himself having to acquire all of the shares of a specific class and he may not be able to afford all these shares. This may possibly result in the acquirer abandoning the transaction due to the financial burden it has, this in turn prejudices the previous shareholders who are happy and who have accepted the initial offer.

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<sup>95</sup> S 123 (2) (a) (i) of the Act.

<sup>96</sup> S 123 (2) (a) (ii) of the Act.

<sup>97</sup> S 123 (2) (b) of the Act.

<sup>98</sup> S 123 (2) (c) of the Act.

<sup>99</sup> S 123 (5) of the Act.

<sup>100</sup> S 123 (3) of the Act.

<sup>101</sup> S 123 (4) of the Act.

#### 2.4.4 RESTRICTIONS ON FRUSTRATING ACTIONS.

Section 126 of the Act<sup>102</sup> provides that the company's board may not take any action that may result in an offer made in good faith being frustrated or shareholders of the company/holders of securities being denied an opportunity to decide on the given merits regarding the bona fide offer. Also, the company's board may not take any action without prior approval of the company's shareholders in relation to issuing any authorised but unissued securities, issue options in regards to unissued securities, enter into contracts other than in the ordinary course of business, make distributions that are abnormal in respect of timing and amounts, sell or acquire assets of a material amount other than in the ordinary course of business and issue any securities that are carrying rights of conversion into other securities.<sup>103</sup>

Even though the provision protects the interests of shareholders by restricting the frustrating actions it can however compromise the shareholders' interests as well. It may happen at times that frustrating an action under certain circumstances can turn out to be what is in the best interests of shareholders. This conclusion is drawn from the fact that in the United States of America, a board of directors is allowed to utilise defensive actions to frustrate a proposed takeover as long as there is a threat to the company and that frustrating the action is in the best interest of the company.<sup>104</sup> For example in the case of *Unocal v Mesa Petroleum*,<sup>105</sup> court applied the principles of the business judgment rule that the board acted in good faith, acted with degree of care, skill and diligence and in the best interest of the company. It held that if there is a threat to a company and that frustrating the takeover is reasonable given the nature of the threat then a board may proceed to frustrate the takeover. Now on how is a threat affecting a company infringing the shareholders' interests, one would know that what is in the best interest of the company is what is in the best interest of the shareholders as the shareholders are the owners of the company.

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<sup>102</sup> S 126 (1) of the Act.

<sup>103</sup> *Ibid.*

<sup>104</sup> Boardman N n14 333.

<sup>105</sup> 493 A.2d 946 (Del. 1985).

## **CHAPTER THREE**

### **PROTECTION OF CREDITORS**

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#### **3.1. INTRODUCTION.**

The creditors of a company are exposed to risk in the context of mergers and acquisitions. An example of such an instance is where two companies merge and as a result of the merger even though the liabilities of the merged companies are transferred by operation of law to the surviving or newly formed company. The latter company becomes insolvent and is unable to pay its creditors. The Act has provided protective measures in this regard to guard against the prejudice of creditors which are the liquidity and solvency test in terms of section 113,<sup>106</sup> the effect of a merger in terms of section 116(7), a notification of merger to creditors in terms of section 116<sup>107</sup> and section 166 of the Act in terms of the alternate dispute resolution.<sup>108</sup>

#### **3.2. THE MERGER NOTIFICATION.**

Section 116 of the Act<sup>109</sup> provides that a notification is to be given to the creditors of the company and that this notification is given by each of the merging companies to every known creditor of that company. This notification is filed with the commissioner along with a statement that says there are no reasonable grounds that exist to believe that any creditor would be prejudiced by the merger. Under this section creditors of a company may within fifteen business days of receiving the notice seek leave to apply to court for a review of the merger but that is only if the creditor will be prejudiced by such a merger.<sup>110</sup> The court will only grant leave if it is satisfied that the application is made in good faith, that the creditor is prejudiced and that there is no other remedy that is available at the creditor's disposal.<sup>111</sup>

This provision provides adequate protection to creditors as it serves as an alert for prejudice and gives creditors opportune time to challenge the merger should they feel that they will be prejudiced by it. One flaw about this provision is that seeking leave to apply to the court and bringing the actual application to the court costs money and a creditor who does not have

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<sup>106</sup> S 113 of the Act.

<sup>107</sup> S 116 of the Act.

<sup>108</sup> S 166 of the Act.

<sup>109</sup> S 116 of the Act.

<sup>110</sup> S 116(1)(b) of the Act.

<sup>111</sup> S 116(1)(c) of the Act.

financial means to legally challenge the transaction will not be able to utilise this protective measure.

### **3.3. THE SOLVENCY AND LIQUIDITY TEST.**

Section 113(4) of the new Act<sup>112</sup> requires that the board of directors of each of the merging companies to consider whether upon the implementation of the merger agreement each of the merging companies will satisfy the solvency and liquidity test. Only when the board of the company is satisfied that each of the merging companies will satisfy the solvency and liquidity test they may then submit the merger agreement to shareholders for consideration.<sup>113</sup> This means that assets of each company when fairly valued must exceed the liabilities of that company. Also, each company must be able to pay its debts as they become due in the ordinary course of business and for a period of twelve months after test.<sup>114</sup>

The new Act simply requires that directors must have reasonable grounds for believing that the company will be satisfy the solvency and liquidity test.<sup>115</sup> This is no guarantee that the company will be liquid and solvent after the implementation of the merger agreement, it may happen that the company does not satisfy the liquidity and solvency test after the implementation of the merger agreement. With the latter in mind the Act does not impose an absolute liability on the directors of the company and the business judgment rule in terms of section 76(4) of the new Act provides protection to directors if they acted in good faith and believed on reasonable grounds that the decision was in the best interest of the company. Lastly, the new Act does not provide a statutory right to a creditor in such an instance just as provided for a shareholder.

### **3.4. EFFECT OF THE MERGER.**

Section 116(7) of the Act<sup>116</sup> provides that as soon as an amalgamation or a merger agreement has been implemented. The property of each of the merging or amalgamating companies becomes the property of the newly formed company or surviving company and the newly formed company or surviving company becomes liable for all the obligations of each of the amalgamating or merging companies in accordance with the provisions of the amalgamation or merger agreement. The importance of this provision is to make sure that the amalgamating

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<sup>112</sup> S 113(4) of the Act.

<sup>113</sup> *Ibid.*

<sup>114</sup> S 4(1) of the Act.

<sup>115</sup> S 113(4)(b) of the Act.

<sup>116</sup> S 116(7) of the Act.

or merging companies do not evade their liabilities when the amalgamation or merger agreement is implemented, in turn providing protection to the creditors of a company.

However, there are weaknesses that are associated with the provision as it can be circumvented by structuring the merger as a triangular merger. A triangular merger is an acquisition structure where a holding company acquires a target company using its wholly-owned subsidiary company. The wholly-owned subsidiary company is merely incorporated to serve as a shelf company and has not assets or liabilities. Now since the wholly-owned subsidiary is the one that is merging with the target company and not the holding company itself, the holding company evades the liabilities of the target company.

### 3.5. **ALTERNATE DISPUTE RESOLUTION.**

Another possible remedy for creditors is found under section 166 of the new Act.<sup>117</sup> It provides that any person who is entitled to apply for relief under this Act may refer the matter that could be the subject matter of such an application or complaint for conciliation, mediation or even arbitration to either the Competition Tribunal, an accredited entity as defined under subsection (3) of section 166 of the new Act and any other person.<sup>118</sup> Furthermore, at the end the Companies Tribunal or an accredited entity may record the resolution in a form of an order and this order can be submitted to the court to make it enforceable.<sup>119</sup>

This provision is faster and less expensive as opposed to a court-based procedure because it is based more on direct participation of disputants rather than legal representatives. Nonetheless, it has its own weaknesses as it is believed that it provides ‘second-class justice’ and encourages compromise as compared to a court-based procedure.<sup>120</sup> As the alternate dispute resolution’s outcome can only be made enforceable in the court, on its own reduces its usefulness a creditor might as well approach the court from the first instance.

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<sup>117</sup> S 166 of the Act.

<sup>118</sup> S 166(1) of the Act.

<sup>119</sup> S 167 of the Act.

<sup>120</sup> Goldberg SB *Dispute Resolution* (2012) 9.

## **CHAPTER FOUR**

### **A COMPARATIVE ANALYSIS**

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#### **4.1. INTRODUCTION.**

One of the reasons for the corporate law reform process was to harmonise South African law with the law of other jurisdictions internationally. Based on the latter this chapter will focus on a comparative analysis of the law in South Africa, United Kingdom and the United States of America with regard to the protection of shareholders and creditors in the context of takeovers. In respect of the United States of America, the comparison is based on the Model Business Corporation Act<sup>121</sup> as it is used in most of the states in America and the Delaware corporation law<sup>122</sup> as it is the leading law in most of the states in America. The comparison is influenced by the fact that the South African Act is an eclectic mix of law from different jurisdictions and one of those jurisdictions is American law.<sup>123</sup> In respect of the United Kingdom the comparison is based on the United Kingdom Takeover Code<sup>124</sup> and this comparison is motivated by the fact that South African law was influenced by English law and traces of the latter can still be found in the South African law.<sup>125</sup>

#### **4.2. SHAREHOLDER APPROVAL.**

When analysing shareholder approval as a protective measure in favour of shareholders in the context of takeovers the South African approach seems to be better than what the United States of America and the United Kingdom utilise. Such a conclusion is drawn from the fact that when one looks at South African law section 115 (2) of the new Act requires that for the sale of all the assets or greater part of the assets of the company the transaction must be approved by special resolution in a meeting.<sup>126</sup> This means that 75 per cent voting rights need to be in favour of the transaction.<sup>127</sup> In contradistinction it is easier with the Delaware to acquire approval for the sale of all the assets or a greater part of the assets of a company since it only needs to be

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<sup>121</sup> The Model Business Corporation Act of 2002.

<sup>122</sup> The General Delaware Corporation Law of 2001.

<sup>123</sup> Boardman n14 306-7.

<sup>124</sup> The UK Takeover Code.

<sup>125</sup> The DTI policy document 14.

<sup>126</sup> S 115(2)(a) of the new Act.

<sup>127</sup> S 1 of the new Act.

authorised by a resolution that is adopted by a majority of the shareholders<sup>128</sup> and this majority is of at least 50 per cent voting rights.<sup>129</sup>

Furthermore, in South Africa whenever voting takes place a quorum must be present in the meeting meaning an aggregate of at least 25 per cent of voting rights must be present at the meeting.<sup>130</sup> Also, if the shareholders of the company seek greater protection from a fundamental transaction they make the quorum to be higher than 25 per cent in the memorandum of incorporation.<sup>131</sup> The latter gives greater protection than the protection that is given under Delaware even though it provides that an aggregate of voting rights may not be reduced to less than a minimum of one third of the shareholders or proxy that are or is entitled to vote at the meeting.<sup>132</sup> It seems clear that in South Africa the provisions in relation to a quorum give room to make a quorum to be higher than what the Delaware prescribes.

In the South African Act it is stated that the sale of fifty per cent or more of the company's assets will trigger the shareholder approval resolution.<sup>133</sup> The Delaware Act is quiet on the percentage that triggers the shareholder approval when coming to the sale of all the assets or a greater part of the assets by a company. Even though in an opinion by Leo Strone of the Delaware Chancery Court in 2004 it was held that shareholder approval will be required if there is a disposal of everything, as 'substantially all' was taken to mean everything.<sup>134</sup>

In the United States of America there are some states that use the Model Business Corporation Act and for these states there is no approval of the shareholders of a company needed in order to sell or dispose of any or all of the company's assets in the usual or regular course of business.<sup>135</sup> Not unless of course if the selling or disposal would leave the company without a significant continuing business activity then the company shareholder approval will be required.<sup>136</sup> This position provides no protection as compared to the provisions that are found under South African law as discussed above.

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<sup>128</sup> S 217 of the Delaware General Corporation Law, Title 8.

<sup>129</sup> S 216 of the Delaware General Corporation Law, Title 8.

<sup>130</sup> S 115(2)(a) of the new Act.

<sup>131</sup> Cassim et al n48 691.

<sup>132</sup> S 216 of the Delaware General Corporation Law, Title 8.

<sup>133</sup> As defined in s 1 of the new Act.

<sup>134</sup> *Hollinger Inc v Hollinger International Inc* 2004 C.A No. 543-N.

<sup>135</sup> S 12.01 of the Model Business Corporation Act of 2002.

<sup>136</sup> S 12.02 of the Model Business Corporation Act of 2002.

Lastly, the position in the United Kingdom is no better than the position in the United States of America as it provides no statutory regulation regarding the shareholders' approval when it comes to selling or disposing of any or all of the company's assets. Especially when it comes to the unlisted companies there is no shareholder approval, but chapter ten of the United Kingdom Listing Rules requires that whenever there is a disposal of twenty five per cent or more of a listed company's assets.<sup>137</sup> There needs to be an ordinary resolution and an explanatory circular to the shareholders of the company.<sup>138</sup> This rule applies to both the disposing and acquiring company as long as it is a listed company.

#### 4.3. THE APPRAISAL REMEDY.

With regards to the appraisal remedy the Delaware law provides the best approach when it comes to the method of valuation of share worth as opposed to the South African approach. This is because the approach that is followed in South Africa is that the courts have a discretion to make an order as to what is the fair market value. As indicated in chapter two this market value is not the automatic method of valuation since in many cases it is not reflective of the true worth of the company. The approach that is followed in some of the states in the United States of America is that there are Delaware courts that specialise in valuation. These courts have a broad understanding apart from expertise when it comes to the interpretation of 'fair value' and the appraisal evaluation method.<sup>139</sup> Therefore, South Africa should follow this approach.

In addition to the issue of approaching the court for a fair market value as discussed above. The Delaware law approach should only be followed as far as the appraisal evaluation method is concerned and not on the fact that that the appraisal goes straight to the court without the company making offer to the dissenting shareholder first.<sup>140</sup> The South African approach in this regard should still be kept as it provides a more comprehensive approach. This is because the dissenting shareholder can ask for a fair market value of his shares from the company and the board must make an offer to the dissenting shareholder. Only when the dissenting shareholder is not satisfied with the offer made by the company's board being a fair market value of his shares then can he approach the court.<sup>141</sup> This is a better approach because if the

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<sup>137</sup> 10.2.2 of Chapter 10 of the UK Listing Rules.

<sup>138</sup> 10.5.1 of Chapter 10 of the UK Listing Rules.

<sup>139</sup> Cassim n50 169-70.

<sup>140</sup> S 262(k) of the Delaware General Corporation Law, Title 8.

<sup>141</sup> S 164(3) of the new Act.

board makes a reasonable offer or gives a fair market value to the dissenting shareholder for his shares the matter ends there. The dissenting shareholder does not only have the expensive option of having to acquire legal advice to approach the court and an option which can be time consuming as leave to apply to the court has to be made before an actual application can be made.

Under the Delaware law for a shareholder to be able to utilise the appraisal remedy, the remedy needs to be provided for in a company's certificate of incorporation.<sup>142</sup> The South African approach seems better regarding this particular provision considering the fact under Delaware law a shareholder cannot utilise an appraisal remedy if it is not included in the certificate of incorporation of the company. This also makes it possible for a controlling shareholder to structure an acquisition in such a way that he is able to avoid events that trigger the appraisal right.

Under the Model Business Corporation Act the appraisal remedy is not available to shareholders whose shares are listed under the New York Securities Exchange.<sup>143</sup> The South Africa approach in this regard seems to be better since even shareholders in companies that are listed in the Johannesburg Stock Exchange can appraise. Furthermore, considering the fact that the Model Business Corporation Act states that a shareholder whose shares are not listed under the New York Securities Exchange<sup>144</sup> when voting he must not vote in favour of the action<sup>145</sup> and if he fails then he will not be entitled to payment.<sup>146</sup> The fact that if a shareholder loses a step he will not be entitled to payment makes the Model Business Corporation Act to be subject to the same criticism as the South African appraisal right provided under chapter two. That the appraisal remedy even though it is a shareholder protective measure it is skewed in favour of the company as opposed to the shareholder.

#### 4.4. MANDATORY OFFER.

In South Africa section 123 of the new Act<sup>147</sup> obliges an acquirer of the company's securities to make a mandatory offer to all the shareholders of a company if a person has acquired a

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<sup>142</sup> S 262(c) of the Delaware General Corporation Law, Title 8.

<sup>143</sup> S 13.02(b) (1) of the Model Business Corporation Act of 2002.

<sup>144</sup> S 13.21(a) (1) of the Model Business Corporation Act of 2002.

<sup>145</sup> S 13.21(2) (2) of the Model Business Corporation Act of 2002.

<sup>146</sup> S 13.21(b) of the Model Business Corporation Act of 2002.

<sup>147</sup> S 123 of the new Act.

substantial beneficial interest in the voting rights.<sup>148</sup> A person is now able to exercise at least thirty five per cent of the voting rights in the company but before he was only able to exercise less than thirty five per cent of the voting rights in the company<sup>149</sup> and the company in question reacquires securities that have voting rights in terms of a scheme of arrangement.<sup>150</sup>

When comparing the United States of America to South Africa, in the United States of America there are a number of second generation statutes that were passed by individual states. Their objective was to provide protection to the minority shareholders whenever there is a change of control in a company. These statutes require that whenever a shareholder obtains a specific number of shares it triggers the rights of all the other remaining shareholders in the company to have their shares purchased as well.<sup>151</sup> These statutes provide a similar protection that is provided under the mandatory offer in the South African Act as a shareholder who holds a beneficial interest in voting rights must make an offer to the remaining shareholders of the company. The only difference which is in criticism and puts the South African approach at a better position is the fact that these statutes do not provide a specific percentage which leaves the users of these statutes with uncertainty regarding an exact threshold which proves to be vital.

In comparison with the position in the United Kingdom, under the United Kingdom Takeover Code it is a mandatory rule that a person who has acquired shares in a company that carry thirty per cent or more of the voting rights,<sup>152</sup> or a person who holds shares that are not less than thirty per cent, but not more than fifty per cent of the voting rights and that person acquires an interest in any other shares that have an effect of increasing the percentage of shares that carry with them voting rights. Such a person has to make an offer to the holders of the other securities that carry with them voting or non-voting rights.<sup>153</sup> The offer must be cash and the highest price paid by the offeror within the twelve months before the commencement of the offer.<sup>154</sup> The South African approach provides a difference of five per cent on a minimum and does not have the maximum regarding the percentage of shares that have voting rights which the acquirer

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<sup>148</sup> S 123(2)(a) (ii) of the new Act.

<sup>149</sup> S 123(2)(c) of the Act.

<sup>150</sup> S 123(2)(a) (i) of the Act.

<sup>151</sup> Fay KJ 'State takeover laws: shareholder protection, the constitution, and the Delaware approach' (1988) *Gonzaga Law Review* 249–61.

<sup>152</sup> Rule 9.1(a) of the UK Takeover Code.

<sup>153</sup> *Ibid.*

<sup>154</sup> Rule 9.5 of UK Takeover Code.

needs to have in order to make a mandatory offer but whether this makes it an inferior approach that is subject to interpretation.

#### **4.5. DISCLOSURE OF SHARE TRANSACTIONS.**

In South Africa section 122 of the new Act<sup>155</sup> provides that any person in a company who acquires or happens to dispose of a beneficial interest concerning the shares of a company. In terms of the disclosure requirements they must notify the company that is if the beneficial interest spoken of is an acquisition or a disposal of a person's shares that are above five per cent. If this is the case the company must be notified of the transaction within three business days after the person concerned has disposed of or has acquired such beneficial interest.<sup>156</sup> The company must then give this information to the Takeover Regulation Panel and other shareholders in the company.<sup>157</sup> The South African approach in providing shareholder protection in respect of share transaction disclosure is effective as it is.

However, there is always that possibility that greater protection can be provided to shareholders in South Africa should there be a lower threshold that triggers the disclosure of a share transaction, even if the threshold is not as low as the one in the United Kingdom. In the United Kingdom whenever a person has acquired one per cent or more of the securities of any class of an offeree company or an exchange of securities by the offeror for the offeree's securities. The person must make a public opening position disclosure after the commencement of an offer period or if later, after the announcement that first identifies any securities exchange offeror.<sup>158</sup>

#### **4.6. RESTRICTIONS ON FRUSTRATING ACTIONS.**

The position in South Africa regarding restrictions on frustrating actions under section 126 of the Act.<sup>159</sup> It is provided that the board of a company may not take any action without approval of shareholders of the company's securities if the action taken will lead to a bona fide offer being frustrated, or take any action in relation to the affairs of the company that will lead to holders of the securities of the company being denied an opportunity to decide on their own merits. Furthermore, the company's board may not take any action without prior approval of the company's shareholders in relation to issuing any authorised but unissued securities, issue

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<sup>155</sup> S 122 of the Act.

<sup>156</sup> S 122(1)(a) and (b) of the Act.

<sup>157</sup> S 122(3)(b) of the Act.

<sup>158</sup> Rule 8.3 of the UK Takeover Code.

<sup>159</sup> S 126 of the Act.

options in regards to unissued securities, enter into contracts other than in the ordinary course of business, make distributions that are abnormal in respect of timing and amounts, sell or acquire assets of a material amount other than in the ordinary course of business and issue any securities that are carrying rights of conversion into other securities.

The approach in the United States of America is discussed briefly in chapter two. It is an approach where the board of directors are allowed to use aggressive defensive actions that will lead to the frustration of potential suitors.<sup>160</sup> This happened as a result of letting each state to regulate its own board anti-takeover defensive conduct through state legislation and the interpretation of state courts which gave rise to a body of case law.<sup>161</sup> This means that the judiciary plays a pivotal role in determining whether or not the board of directors have acted detrimental to the shareholders of the company.<sup>162</sup> Just as indicated in chapter two in the case *Unocal v Mesa Petroleum*<sup>163</sup> the court applied the business judgment rule to a takeover defence. It held that the board of directors may prevent a takeover if it can be shown that there actually was a threat regarding the company's policy and that the defensive measure that was applied was reasonable given the nature of the threat. This is after Mesa Petroleum had made a hostile bid for the Unocal Corporation which it tendered \$54 in cash and \$54 in junk bonds. Unocal shareholders were expected to tender their shares even if they thought that \$54 was a fair price. As a result Unocal made a self-tender at \$72 for all the shares under Unocal. This approach is a more flexible approach as compared to the South African approach because under this approach the board of directors can frustrate an offer and the courts have a discretion to decide whether or not this board has acted detrimental to the shareholders of a company. But whether this approach is the best in terms of making sure the shareholders are protected it would seem not, since by allowing the courts to decide whether the board has acted detrimental to the shareholders compromises the provision which is a sense of security and surety in protecting shareholders.

In the United Kingdom, the common law position was that English courts allowed takeover defences as long as there was a proper purpose of advancing the company and the interests of shareholders. As long as it was not illegitimate management decisions that were structured in

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<sup>160</sup> Boardman N n16 333.

<sup>161</sup> Armour C, Jacobs J and Milhaupt J 'The Evolution of Hostile Takeover Regimes in Developed and emerging Markets' (2011) *Harvard International Law Journal* 220-41.

<sup>162</sup> Luiz S 'An Evaluation of the South African Securities Regulations Code on Takeovers And Mergers' 2003 *Thesis UNISA* 461.

<sup>163</sup> 493 A.2d 946 (Del. 1985).

a manner that secured directors positions on the board.<sup>164</sup> However, this position has changed as the Takeover Code abolished these common law rules. The Takeover Code requires that the board of directors must act in the interests of the company as a whole and they must not in any way deny the shareholders the opportunity to decide on the merits of the bid.<sup>165</sup> The common law position in the United Kingdom was more flexible just like the position in the United States of America currently but this has since changed. The current approach in the United Kingdom is similar to the South African approach and the United Kingdom has since moved from the common law position. This then proves with more reason that the flexible approach is not the appropriate approach in providing protection to the shareholders as indicated in the above paragraph.

#### 4.7. PROHIBITED DEALINGS BEFORE AND DURING OFFER.

In terms of section 119(2)(b) (ii) the Panel is mandated to ensure that *inter alia* shareholders of the same class are treated equally. Section 127 reinforces this consideration for equal treatment of shareholders by providing that when an offer is in contemplation, an offeror must not make an arrangement with the holders of the securities or make arrangements regarding an acceptance of an offer if those arrangements are not being extended to all holders of securities.<sup>166</sup>

The United States of America under the Securities and Exchanges Act requires that when a tender offer is made to all the shareholders in a specific class of shares that the consideration that is paid in terms of the offer must be the highest consideration paid to any of the shareholder for shares tendered in the tender offer.<sup>167</sup> Furthermore, the offeror is allowed to acquire securities during the offer period but only if the acquisitions of such securities is part of the offer. In South Africa it is prohibited that the offeror acquires the securities of a company during the offer period without the consent of the Takeover Regulation Panel and the person who is disposing those securities making a public announcement that such a sale is made in accordance with the Act.<sup>168</sup> The South African approach seems to be providing greater protection to shareholders as opposed to the American approach where an acquirer does not

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<sup>164</sup> Johnston A 'Takeover Regulation: Historical and Theoretical Perspectives on the City Code' (2007) 66 *Cambridge Law Journal* 436.

<sup>165</sup> Rule 21.1(a) of the UK Takeover Code.

<sup>166</sup> S 127(1)(a)-(c) of the Act.

<sup>167</sup> S 240 of the USA Securities and Exchange Act of 1934. Rule 14d-10.

<sup>168</sup> S 127(2) of the Act.

have to seek consent. In South Africa the offeror cannot acquire securities of a company during an offer unless exempted by the Takeover Regulation Panel. A panel whose regulatory power is mainly for ensuring the fairness and equal treatment of shareholders as discussed in chapter two.

In the United Kingdom, a person can acquire an interest in the shares of a company before the offer, if the offer would result in the offeror having shares that carry with them thirty per cent or more but less than hundred per cent of the voting rights in the company. Consent for such will normally be given if the offeror has acquired a significant number of shares from the offeree company during the twelve months from the date of having made an application for consent.<sup>169</sup> Also, a person may not acquire any shares in a company which is the offeree during the offer period and in a case of a successful partial offer. The offeror during the course of the offer can only with the consent of the Panel acquire shares during a period of twelve months after the end of the offer.<sup>170</sup> Therefore, the approach that is used in the United Kingdom is that dealings are prohibited during offer but are accepted before and after an offer subject to consent. The consent for a dealing made before an offer has a threshold which is superfluous.

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<sup>169</sup> Rule 36.2 of the UK Takeover Code.

<sup>170</sup> Rule 36.3 of the UK Takeover Code.

# CHAPTER FIVE

## CONCLUSION

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### 5.1. INTRODUCTION.

The main aim of the study was to identify the strengths and weaknesses of the measures introduced in the new Act which protect the shareholders and creditors of a company in the context of takeovers and reorganisations. In answering this question a critical and analytical study of the protective measures in the Act that relate to the protection of shareholders and creditors was undertaken. A comparative study of South African law with the law in the United States of America and the law in the United Kingdom was also undertaken. In this chapter findings from both research methods are listed and recommendations for improving the relevant protective measures are made.

### 5.2. FINDINGS AND RECOMMENDATIONS.

The discussion in chapter two showed that the appraisal remedy in section 164 protects shareholders in the context of fundamental transactions by enabling a shareholder to exit the company with the fair value of his shares.

However, chapter two also showed that there are some weaknesses associated with section 164 such as its complexity that can make the dissenting shareholder to miss a step in executing such a remedy, which can result in a shareholder losing this right. In addition to this, the fact that the court has a discretion to make an order as to what is the fair market value of the securities and which may be unfavourable to the shareholder at times.

To address the above weaknesses it is recommended that section 164 of the Act be amended in such a manner that even if a shareholder misses any step, non-compliance may be condoned by the court and he should still be able to exercise the right. Furthermore, on the point that the court can make an order it deems is the fair market value of the securities and which may be unfavourable to the shareholder at times. Cassim makes the point that the valuation made by our courts as to what is the fair market value of the securities is not the automatic method of valuation.<sup>171</sup> This is because in many cases it is not reflective of the true worth of the company.

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<sup>171</sup> Cassim n50 169-70.

She opts we follow the approach used in the United States of America where they have courts that specialise in valuation. Courts that have expertise when it comes to the interpretation of ‘fair value’ and the appraisal evaluation method.<sup>172</sup>

Section 164(9) of the Act needs to be amended in such a manner that even if the shareholder sends a written demand to the company asking for a fair market value of his shares, the shareholder does not lose further rights regarding those shares as the current *status quo* provides.<sup>173</sup>

Lastly, the current *status quo* of what a board of a company or the court may find as a fair market value of the shareholders shares is paid at the end of the appraisal proceedings. This needs to be amended to provide for a provisional payment of what the company deems a fair market value of the shareholders shares at the beginning stages of the appraisal proceedings and then the rest of the payment to be made at the end of the appraisal proceedings.<sup>174</sup> This would give the shareholder immediate use of his funds as opposed to the current *status quo* where a shareholder is deprived of the use of his funds until the end of appraisal proceedings.<sup>175</sup>

In chapter two it was shown that the requirement for approval of fundamental transactions by means of special resolution of the shareholders serves to protect shareholders but it was also shown that it has its weaknesses. To eliminate these identified weaknesses section 115(2)(a) of the Act should be amended in such a way that in matters of urgency the shareholders’ approval can be bypassed. The matters of urgency referred to on the latter are grounds that places a company in a position to make expedient decisions. For example, where there is an offer made to the company and considering the time of having to convene a meeting to get approval for such a transaction the opportunity will be lost to other companies. Therefore, by passing the shareholders’ approval would be the best solution at that point in time. The directors of a company should be the people who take the decision based on the business judgment rule in cognisance of the provisions of frustrating actions.

Moreover, as pointed out in chapter two about the provision of a company having to seek court approval to continue and implement a fundamental transaction having its own weaknesses. One of these weaknesses is the fact that section 115(3)(b) of the Act needs a shareholder who wants

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<sup>172</sup> *Ibid.*

<sup>173</sup> Cassim et al n48 808.

<sup>174</sup> S 112(4) of the New Zealand Companies Act of 1993.

<sup>175</sup> Cassim et al n48 808.

to utilise this section to have voted against the resolution of a proposed transaction. This section needs to be amended in a manner in which even if a shareholder did not vote against the resolution of adopting a fundamental transaction can still utilise this protective measure. Those shareholders who did not vote against the resolution will have to bring a leave to apply to the court with a condonation. This means that they will have to disclose reasons as to why they did not vote against the resolution whilst they had an opportunity to do so. The condonation will eliminate this technicality which makes it difficult for a shareholder who is prejudiced by the adoption of a transaction to challenge it. The requirement that the shareholder must have voted against the resolution may be seen as promoting shareholder activism by forcing shareholders to participate in fundamental transactions involving companies in which they are invested. Nonetheless, the failure of meeting this requirement should not confine a shareholder to a transaction that is unfair to him or a transaction that prejudices him and for the shareholder not to have a way out. Another opportunity needs to be afforded to the shareholder and the recommendation provides just that.

Lastly, in chapter two it was indicated that regulation 88 which exempts partial offers from compliance with the Act and regulations if the offeror when making an offer tends to hold securities entitling him as the offeror to exercise voting rights equal to, or in the excess of the prescribed percentage needs to be amended. The amendment will ensure that minority shareholders are protected at every acquisition because with the *status quo*, the rights of the minority are not protected at every single acquisition but they are only protected when an offer results in the offeror moving from a position of voting rights that is below a position that is above the prescribed percentage or even acquiring hundred per cent of the voting rights.

The research has identified the strengths and weaknesses of the measures introduced in the new Act which protect the shareholders and creditors of a company in the context of takeovers and reorganisations. The research provides insightful recommendations and calls for an amendment of the new Act regarding the identified weaknesses.

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