Articles

The Introduction of the Statutory Merger in South African Corporate Law: Majority Rule Offset by the Appraisal Right (Part 1)

MALEKA FEMIDA CASSIM*
University of the Witwatersrand

> '[T]he amalgamating companies continue without subtraction in the amalgamated corporation, with all their strengths and weaknesses, their perfections and imperfections and their sins, if sinners they be.'[1]

> 'At one moment two corporations exist; at the next, the acquiring corporation has enveloped the target, like an amoeba engulfing its prey, and has succeeded to all of its properties, rights and other attributes.'[2]

1 Introduction

A fundamental and radically new concept of the statutory merger, borrowed from the United States of America, is to be introduced into South African law by the new draft Companies Bill, 2007[3]. The statutory merger, in essence, is 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, and without the need for any court approval. Instead of recourse to a court, dissenting shareholders have the right to opt out, by withdrawing the fair value of their shares in cash. This they do by exercising their appraisal rights.

The statutory merger represents a significant liberalisation of policy on the part of the Legislature between the conflicting values of, on the one hand, facilitating the restructuring of businesses in the interests of economic growth and, on the other hand, the interests of shareholders in retaining their investments in companies together with the protection of minority shareholders from discrimination at the hands of the majority. This dramatic shift in policy follows a similar trend in America, a trend also adopted in Canada and New Zealand.[4]

* MBBCh LLB LLM (Witwatersrand). Lecturer, Faculty of Law, University of the Witwatersrand. Attorney of the High Court South Africa.

[1] Per Dickinson J in *R v Black & Decker Manufacturing Co* [1975] 1 SCR 411 (SCC) at 422.

[2] Ronald J Gilson *The Law and Finance of Corporate Acquisitions* (1986) at 505.

[3] See GN 166 of 2007 in *GG* 29630 of 12 Feb 2007.

[4] See Wayne D Gray *The Annotated Canada Business Corporations Act 1995* (1994) at 361; William T Allen & Reinier Kraakman *Commentaries and Cases on the Law of Business Organizations* (2003) at

Cite as: (2008) 20 *SA Merc LJ* 1–32.

This article first addresses the concept of the statutory merger in general in par 2. The definition and the juridical nature of the statutory merger is discussed in par 2.1, followed by an analysis of the merger procedure in par 2.2 and the inherent protective measures for shareholders and creditors in par 3. Next follows in par 4 a discussion of the underlying policy issues that led to the introduction of the statutory-merger procedure in South African law.

In pars 5-10 significant merger structures are adumbrated and analysed, with a specific focus on the triangular and reverse triangular merger, the freeze-out merger and the short-form merger.

The appraisal right is critically addressed in pars 11-14. The discussion of the appraisal right encompasses both a critical analysis of the procedure for perfecting and exercising the appraisal right, as well as the valuation of shares in appraisal proceedings. Paragraph 15 considers more fully further the exceptional requirement of court approval of mergers and, where relevant, addresses the interplay between court approval and the appraisal right.

2 The Statutory Merger

2.1 Definition and Effect of a Merger

The Companies Bill makes provision for both mergers and amalgamations. A merger is defined as

> 'a transaction, or series of transactions, involving two or more companies, resulting in one or more of those companies together holding all of the assets and liabilities previously held by the several merging companies'

while an amalgamation is defined as

> 'a transaction, or series of transactions, involving two or more companies, resulting in the formation of one or more new companies, which together hold all of the assets and liabilities previously held by the several amalgamating companies'.[5]

Accordingly, a merger may be described as the fusion of two or more companies – referred to as the 'constituent companies' or the 'merging companies' – *into one of the constituent companies*, resulting in the survival or continuing existence of that constituent company, termed the 'merged company'[6], which holds *all* the assets and liabilities that were previously held by the several merging or constituent companies.

By contrast, in an amalgamation, both (or all) of the constituent amalgamating companies are dissolved and a *new company* is created, termed the 'amalgamated company',[7] which holds all the assets and liabilities

---

427-9; Ross B Grantham & Charles EF Rickett *Company and Securities Law Commentary and Materials* (2003) at 39.

[5] Clause 1 of the Bill.

[6] Ibid.

[7] In terms of cl 1 of the Bill, the 'amalgamated company' in an amalgamation is the 'company that – (*a*) was incorporated in terms of an amalgamation agreement; (*b*) holds all or part of the assets and liabilities of any of the amalgamating companies; and (*c*) has applied for, or been issued a certificate of incorporation in terms of section 120'.

previously held by the several constituent or amalgamating companies.[8] The vesting of such assets and liabilities in the amalgamated company or the merged company takes place automatically upon effectuation of the merger, simply *by the operation of law*.[9]

Thus, the technical difference between a merger and an amalgamation is that in a merger of an acquiring company, Company A, and a target company, Company T, Company A survives and continues in existence while Company T is the disappearing company and is dissolved or deregistered. In an amalgamation between Company A and Company T, both Companies A and T are dissolved and a new company, Company N, is created. Accordingly, a merger results in the fusion of one constituent company into the other, but an amalgamation results in the fusion of all the constituent companies into a new company. The new company is incorporated in terms of the amalgamation agreement itself. A Memorandum of Incorporation of the newly amalgamated company is filed with the Commissioner (together with the filing of the Notice of Amalgamation), and upon receipt of the filing the Commissioner issues a certificate of incorporation for the new company.[10]

In practice, the choice between a merger and an amalgamation would be determined by a number of factors, such as the desire to portray the transaction as a true merger of equals, in which case an amalgamation may be preferred; the need to preserve the goodwill or the identity of one of the constituent companies, necessitating the use of a merger *into* the relevant company; the material provisions of the Memorandum of Incorporation of the constituent companies, which may determine whether the relevant company must survive or disappear under the transaction; and the change-of-control provisions in material contracts between a constituent company and third parties.[11] Apart from the above differences between mergers and amalgamations, the two procedures are substantially similar in all other respects.

[8] The differing and confusing terminology used in various jurisdictions is noteworthy. In Canada the term 'merger' is not a term of art but is used to describe every form of business combination (see FH Buckley, Mark Gillen & Robert Yalden *Corporations Principles and Policies* 3 ed (1995) at 991), while the term 'amalgamation' is used in Canadian law for the procedure equivalent to a 'merger' under the Bill (see s 181 of the Canada Business Corporations Act, 1985 (RSC 1985 c C-44). A 'merger' in Delaware is equivalent to a 'merger' under the Bill, but the Delaware equivalent of an 'amalgamation' in terms of the Bill is a 'consolidation' (see s 251(*a*) of the Delaware General Corporation Law, 2001). In New Zealand the term 'amalgamation' is used to describe both the equivalent of a 'merger' as well as an 'amalgamation' as those terms are defined in the Bill (see s 219 of the New Zealand Companies Act 105 of 1993).

[9] See the wording of cl 120(5) of the Bill; see also Stephen Kenyon-Slade *Mergers and Takeovers in the US and UK Law and Practice* (2003) at 29 in respect of the equivalent provision in s 259(*a*) of Delaware General Corporation Law, 2001; see also Stephen M Bainbridge *Corporation Law and Economics* (2002) at 628 on the equivalent provision in s 11.07 of the American Revised Model Business Corporation Act of 1984, as amended.

[10] See cl 120(1) and (3) of the Bill.

[11] See Arthur R Pinto & Douglas M Branson *Understanding Corporate Law* (1999) at 122; Kenyon-Slade op cit note 9 at 7.

Turning to the juridical nature and effect of a statutory merger, this was aptly described in the following terms in *R v Black & Decker Manufacturing Co*:[12]

> '[T]he purpose is economic: to build, to consolidate, perhaps to diversify, existing businesses; so that through union there will be enhanced strength. It is a joining of forces and resources in order to perform better in the economic field. If that be so, it would surely be paradoxical if that process were to involve death by suicide or the mysterious disappearance of those who sought security, strength and, above all, survival in that union . . . . [T]he end result is to coalesce to create a homogenous whole. The analogies of a river formed by the confluence of two streams, or the creation of a single rope though the intertwining of strands have been suggested by others.'

In harmony with the juridical nature of a merger, the Companies Bill explicitly provides that neither a merger nor an amalgamation affects the existing liability of any of the constituent companies to criminal prosecution (that notwithstanding the disappearance or dissolution of the relevant constituent company in the process), nor does it affect any action or proceeding by or against, or any conviction, ruling, order or judgment relating to, a constituent company, which may therefore continue to be prosecuted or enforced by or against the surviving merged company or the newly amalgamated company, as the case may be.[13]

Significantly, cl 120(5)(*a*) of the Bill states that upon effectuation of a merger (or an amalgamation, as the case may be), all the property of the several constituent companies 'becomes' the property[14] of the surviving, merged company. Moreover, the surviving merged company 'is liable' in terms of cl 120(5)(*b*) for all of the obligations of the several constituent companies in a merger. Since the vesting of the assets and liabilities in the surviving merged company (or the acquiring company) occurs automatically, by the operation of law,[15] there is no need for compliance with any of the legal formalities associated with transfer, nor any need for a court order effectuating transfer.

The statutory merger consequently provides for simplicity and efficiency, with a savings of costs and time, and for the acquiring company to obtain full ownership of the target company or disappearing company. But an attendant disadvantage of the merger procedure is that the acquiring company is, conversely, also automatically liable for all the obligations and liabilities of

---

[12] Supra note 1 at 420-2.

[13] See cl 120(4) of the Bill.

[14] 'Property' in the context of cl 120(5)(*a*) would presumably be interpreted in its broad sense to include all property, rights, powers and privileges. In this regard the term 'property' in the equivalent s 186(*b*) of the Canada Business Corporations Act, 1985 has been held to mean all rights, powers, privileges and franchises: see, eg, *Loeb Inc v Cooper* (1991) 5 OR (3d) 259, 3 BLR (2d) 8 (Gen Div, Ont); see also *Norcan Oils Ltd v Fogler* [1965] 36, 49 WWR 321, 46 DLR (2d) 630 (SC, Alta) in relation to the Companies Act, 1955 (RSA c 53) and *Re Yustin Construction Ltd* (1986) 5 PPSAC 154, 57 CBR (NS) 320 (Ont SC) in relation to the Ontario Business Corporations Act, 1980 (RSO c 54), both of which followed a similar interpretation. Also, compare cl 120(5)(*a*) of the Bill with the equivalent provision in s 225 of the New Zealand Companies Act, 1993 which refers to 'property, rights, powers, and privileges' and s 259 of the Delaware General Corporation Law, 2001 which similarly refers to 'rights, powers, privileges and franchises_ and all property real, personal and mixed'. These sections may well influence the interpretation of 'property' in cl 120(5)(*a*) of the Bill.

[15] See note 9 above.

the disappearing company, including unliquidated and contingent liabilities,[16] and even, it seems, for liabilities of which the acquiring company was unaware.

Further consideration must be given to the vesting in the surviving company of the *contractual* rights and obligations of the disappearing company under contracts between the disappearing company and third parties. Generally, most contracts which are silent on assignability would vest in the surviving company in a merger, even without the consent of the third party. The basis of this view is that in a merger the vesting of the rights and liabilities of the disappearing company in the surviving company occurs automatically by the operation of law,[17] and not by a process of assignment or novation.[18] Even where a contract is expressly non-assignable according to its terms, it would nevertheless generally vest in the surviving company in a merger on the basis that a non-assignability clause is not intended to apply to a transfer by the operation of law. Thus, if the disappearing company in a merger is a tenant under a lease, no assignment of the lease to the surviving, merged company takes place, with the result that the lessee's consent is not required.[19] But where a contract contains a clause which specifically provides that the contract will not survive a merger, such a clause would effectively prevent the vesting of the contract in the surviving merged company.[20]

A second limitation on the transfer of contractual rights and obligations by the operation of law in a statutory merger arises in respect of purely personal contracts. Courts have laid down[21] that purely personal contracts cannot be transferred because their very nature dictates that they be performed by a particular person only. This principle could also encompass agreements relating to patent licences[22] and other intellectual property rights, especially if

[16] See cl 120(4); see also Robert Charles Clark *Corporate Law* (1986) at 405 in respect of American law.

[17] This is supported by the wording of cl 120(5) of the Bill, namely that upon implementation of a merger all the property of the merging companies '*becomes'* the property of the surviving, merged company, subject to any provision in the agreement to the contrary.

[18] See William L Cary & Melvin Aron Eisenberg *Cases and Materials on Corporations* 6 ed (1988) at 1149 in respect of American law.

[19] See, eg, the Canadian decisions in *Loeb Inc v Cooper* supra note 14 and *Rossi v MacDonald's Restaurants of Canada Ltd* (1991) 25 ACWS (3d) 639 (BC SC). See also the American decision in *PPG Industries Inc v Guardian Industries Corp* 597 F 2d 1090 (6th Cir, 1979), and Dale A Oesterle *The Law of Mergers, Acquisitions and Reorganizations* (1991) at 163.

[20] See Cary & Eisenberg op cit note 18 at 1149 and cl 120(5) of the Bill which provides that the automatic vesting of the property and obligations of the constituent companies in the surviving merged company is 'subject to any provision of the agreement to the contrary' (see further below).

[21] This is the case with schemes of arrangement: see *Nokes v Doncaster Amalgamated Collieries Ltd* [1940] AC 1014 (HL); *Re Skinner (Deceased)* [1958] 3 All ER 273 (P) at 276; JA Kunst, P Delport & Q Vorster *Henochsberg on the Companies Act* Vol 1 (2006) at 639; CCH New Zealand Ltd *Guidebook to Companies and Securities Law* (1994) at 270; *Re 'L' Hotel Co Ltd & Langham Hotel Co Ltd* [1946] 1 All ER 319 (Ch D).

[22] See the American decision in *PPG Industries v Guardian Industries* supra note 19; Oesterle op cit note 19 at 165. However, in America there has been inconsistency and confusion in relation to the issue of licence agreements: see, eg, *Syenergy Methods v Kelly Energy Systems, Inc* 695 F Supp 1362 (DC, RI, 1988), citing *Trubowitch v Riverbank Canning Co* 182 P 2d 182 (SC, Cal, 1947); *TXO Production Co v MD Mark, Inc* 999 SW 2d 137 (Tex Civ App, 1999); JG Graubart 'Unintended Consequences:

they are expressed to be non-transferable or non-assignable without the consent of the licensor.

Indeed, the existence of a material or valuable contract falling within one of these exceptions may be determinative of the structure of the merger transaction, in that in order to secure the continuation of the contract, the merging company which is a party to such an agreement may well have to be the surviving company under the merger, instead of the disappearing company. The use of the reverse triangular merger (a topic I will return to in par 7 below) plays a fundamentally important role in such circumstances.

It is disturbing that cl 120(5) of the Companies Bill provides that the automatic vesting of the property and obligations of the constituent companies in the surviving merged company is 'subject to any provision of the agreement to the contrary'. The 'agreement' in this context would appear to refer to the merger agreement, thus leaving scope for the merging companies voluntarily to exclude certain assets and/or liabilities from the merger transaction. Not only would this be out of step with the basic juridical nature of a merger, but it creates scope for prejudice to the creditors of the disappearing company. It also conflicts with the requirement that the target company must be deregistered by the Commissioner upon the implementation of the merger. The better interpretation is that the 'agreement' referred to in the proviso to cl 120(5) must be taken to refer only to the contracts of a constituent merging company with third parties, such as the lease or licencing agreements discussed earlier. It is submitted that it would be strongly advisable for the words 'subject to any provision of the agreement to the contrary' to be deleted in their entirety from the provisions of cl 120(5).
Having discussed the nature and the effect of a merger, it is apt to turn now to the procedure for effecting a merger.

2.2 The Merger Procedure

The merger procedure in terms of the Companies Bill may conveniently be divided into four steps. First, the merging parties conclude a merger agreement,[23] setting out the terms and manner of effecting the merger, including the consideration receivable by the shareholders of the disappearing company in return for their shares in that company. Secondly, the board of directors of each merging company must have reasonable grounds for believing that the company would, upon the implementation of the merger, satisfy the solvency and liquidity test.[24] Thirdly, the merger must be approved by the prescribed majority of the shareholders of each merging company at a meeting called for that purpose,[25] at which a quorum of the holders at least 25

State Merger Statutes and Nonassignable Licenses' 2003 *Duke Law & Technology Review* 0025 available at *http://www.law.duke.edu/journals/dltr/articles/2003dltr0025.html* (last visited on 30 May 2007).

[23] Clause 117(2) of the Bill.

[24] Clause 117(4) of the Bill.

[25] Clause 119(2)(*a*) of the Bill.

per cent of all the shares entitled to be voted must be present. The prescribed majority entails approval by the holders of at least a simple majority (that is, over 50 per cent) of the shares voted.[26] Finally, the merger is then perfected or implemented and in this regard the merger takes effect, subject to any conditions in the merger agreement, upon the filing of a Notice of Merger with the Companies Commissioner (together with certain other documentation, including a statement relating to the merging companies' creditors, confirmation that the merger was approved by the Takeover Regulation Panel and confirmation that it was approved in terms of the Competition Act 89 of 1998, where so required).[27] The Commissioner at this stage also deregisters the disappearing company, without the need for any winding-up.[28] As stated above, save in special circumstances the approval of the court is not generally required in the four-step merger procedure.[29]

It is noteworthy that the above four-step procedure for effecting a merger applies generally to widely held companies only. Its application to closely held companies is restricted solely to those of them that under their Memoranda of Incorporation choose to opt in, provided that all their shares are not held by persons who are related or inter-related.[30] Apart from these two exceptions, all other companies, including holding and subsidiary companies, are entitled to merge subject only to compliance with the solvency and liquidity test.[31] The implication of this restricted application is that the safeguards for shareholders and creditors, which are inherent in the four-step merger procedure, do not generally apply to protect the shareholders and creditors of the closely held company.

In view of the absence of an active trading market for the shares of closely held companies, it is submitted that shareholders in closely held companies have a much greater need for the statutory protection offered by the merger procedure, and particularly the appraisal right, in the absence of which such shareholders may be unable to sell their shares on the market and thereby opt out of the closely held company should they dissent to a proposed merger of

[26] As determined in accordance with cl 119(4) of the Bill: see cl 119(2)(*ii*)). There appears to be a drafting error in the Bill in that that the reference to cl 119(4) should have been to cl 119(8).

[27] Clause 120(1) of the Bill. Oddly, based on the wording of cl 120(1), the implementation of a merger does not depend on the filing of a Notice of Merger with the Commissioner or on the issue of a certificate of merger by the Commissioner. Clause 120(1) states that the Notice of Merger 'may' (not must) be filed with the Commissioner. It seems, instead, that a merger simply takes effect in accordance with and subject to any conditions set out in the merger agreement: cl 120(4)(*a*). This is undesirable as it creates uncertainty. Rather, the Bill ought to provide that a merger is implemented and takes effect upon the *mandatory* filing of the Notice of Merger with the Commissioner or, where applicable, at such later date as is specified in the Notice of Merger (which date may also be specified in the merger agreement). Indeed, in most American states a merger becomes effective upon filing a Certificate of Merger with the office of the Secretary of State (see, eg, s 251(*c*) rw s 103 of the Delaware General Corporation Law, 2001; see also s 11.06(*b*) of the Revised Model Business Corporation Act, 1984). Canada and New Zealand have adopted similar methods of implementing a merger, that is, by the issue of a certificate of merger by the relevant official (see ss 185 and 186(*a*) of the Canada Business Corporations Act, 1985 and ss 223-5 of the New Zealand Companies Act 105 of 1993).

[28] Clause 120(3) of the Bill.

[29] Clause 119(3)-(6) of the Bill.

[30] As defined in cl 1 of the Bill: see cl 112(3).

[31] Clause 117(1) of the Bill.

the company. Consequently, shareholders in closely held companies would be well advised carefully to consider the contents of the company's Memorandum of Incorporation and to ensure that it contains adequate protection for them, such as a requirement of the unanimous approval by the shareholders of any merger, or put options that give them the right to sell their shares at a specified price in specified circumstances to the company or other shareholders.

Surprisingly, the statutory merger provisions do not extend to foreign companies,[32] so that the Companies Bill does not provide for statutory mergers between a South African company and a foreign company. This approach needs to be reconsidered. Facilitating such mergers would be in the interests of economic growth. It may be contrasted with the position in America where s 11.02 of the Model Business Corporation Act, 1984 permits mergers between domestic and foreign corporations provided that this is permissible under the laws applicable to the foreign corporation and that these laws are complied with. The Model Business Corporation Act further envisages that a foreign corporation may be either the disappearing corporation or the surviving corporation in the merger and it is submitted that our Companies Bill should follow this example.

The four-step merger procedure outlined above encompasses a number of protective measures designed to ensure fairness to shareholders and creditors of merging companies.

3 Protective Measures Inherent in the Merger Procedure

The merger procedure provides protection for shareholders by requiring shareholder approval of the merger agreement, coupled with the appraisal right for dissenting shareholders (more about this right shortly). The fiduciary duties of directors provide further shareholder protection, as does the requirement of court approval of the merger in exceptional circumstances. Amongst the safeguards for creditors are the solvency and liquidity test, and the notice to creditors of the merger together with the opportunity for them to object to the merger within 30 days.[33] These protective measures will now all be considered critically.

3.1 The Requirement of Shareholder Approval

This vital protective measure for shareholders is, in the way it is provided for in the Companies Bill, fundamentally flawed. The shareholder approval requirement under the Bill is inordinately permissive and lenient. The prescribed shareholder approval threshold is a mere simple majority of the eligible shares voted, at a meeting at which the holders of no more than a mere 25 per cent of the eligible shares have to be present. It is significant that

[32] Clause 1 read with cl 7 of the Bill.
[33] Clause 120(1)(*b*)(*i*) and (*ii*) and cl 120(2).

both the quorum and the prescribed shareholder approval relate not to the number of shareholders but to the number of shares.

The eligible shares which may be voted, as determined by cl 119(8),[34] are voting shares,[35] that is, shares that carry voting rights, non-voting shares that are convertible into voting securities and, when applicable, preference shares that are not convertible into voting shares and do not confer any voting rights.[36] This may be compared with Canadian legislation, under which each share carries a right to vote on a proposed amalgamation even though it is otherwise a non-voting share.[37] Disappointingly, the Bill also fails to provide for any form of class voting for the different types of voting shares or, indeed, for any form of class voting at all.

Accordingly, the shareholder approval requirement effectively means that even if the quorum at the meeting of shareholders in respect of an *arms' length* merger[38] is 100 per cent, a single shareholder or small group of shareholders which holds more than 50 per cent of the company's voting shares, effectively has the power to approve or to veto the merger *all on its own* as it wishes, regardless of whether all the other shareholders of the company are or are not opposed to the merger. The Companies Bill is consequently heavily weighted in favour of a dominant, majority shareholder and biased against the numerical majority. The majority shareholder need not even hold as many as 51 per cent of the company's shares in order to be able to approve or to veto a merger purely on the strength of its own vote. Because of shareholder apathy, many shareholders, especially in a company with a large number of minority shareholders each with very small shareholdings, do not generally attend meetings, let alone cast their votes. It is consequently conceivable that, in some cases, a favourable vote of as little as 12,5 per cent of the company's shares would suffice for the approval of a merger (that is, a majority of the shareholders at a meeting at which the bare minimum of the quorum of the holders of 25 per cent of the shares is present.) This raises cause for grave concern and disquiet. It could be particularly problematic for public companies in which large blocks of shares are held by institutional shareholders.

It is submitted that the very lenient shareholder-approval threshold, coupled with the heavy weighting in favour of controlling shareholders provided for

[34] Clause 119(2)(*b*) of the Bill must be taken to refer to cl 119(4) and not to cl 119(8). As already pointed out (see note 26 above), this appears to be a drafting error in the Bill.

[35] As defined in cl 1 of the Bill.

[36] In this regard, cl 119(8) of the Bill provides that any 'voting shares' controlled by an acquiring party or a person acting in concert with an acquiring party are not to be included in determining the number of shares entitled to be voted or the number of shares voted in support of the resolution. This implies that all other 'voting shares' (as defined in cl 1) are entitled to be voted on the merger, but not any other shares which fall outside of the definition of 'voting shares'. Clause 119(8) will be discussed in more detail in pars 8.2 and 9 below.

[37] See s 183(3) of the Canada Business Corporations Act, 1985. While not all Canadian companies are incorporated under this Act, but rather under one or other of the provincial statutes, the Act is the model for most of the provincial statutes.

[38] The position in respect of an *interested or controlled merger* – as opposed to an arms' length merger – is dealt with in pars 8 and 9 below.

by the Bill, manifestly fails to give effective protection to shareholders in an arms' length merger. The Bill is even more lenient than the liberal amendments effected to the American Model Business Corporation Act in 1999, reducing the requisite shareholder approval from 50 per cent *of all the outstanding (or issued) shares* of a company (that is, an *absolute majority* requirement) to approval by a majority *of the votes present at a meeting* at which a quorum is present consisting of a majority of all the votes entitled to be cast (that is, a *simple majority* requirement of all the votes cast).[39] Thus, under the American Act, a vote of just over 25 per cent of the total votes of the company could suffice for a merger, as contrasted with the more 'generous' provisions of the Companies Bill under which support for a proposed merger by as little as over 12,5 per cent of the total shares of the company could suffice.

Moreover and significantly, the voting rules as laid down in the American Act as amended in 1999, have not been adopted by the corporate laws of most American states. They generally still implement an *absolute majority* voting requirement *of all the outstanding or issued shares* of a company (as opposed to a *simple majority* voting requirement *of all the votes cast*), usually at a threshold of either 66,6 per cent of the issued shares,[40] or 50 per cent of the issued shares as for instance in Delaware.[41]

It is submitted that while an *absolute majority* vote is in principle a good concept, it would be ill–suited to South African law as it may make the approval and effectuation of mergers difficult to accomplish in practice, mainly because of shareholder apathy. Instead, it is suggested that the simple majority requirement stipulated in the Bill ought to be increased to a *special majority* requirement by which the proposed merger would have to be approved by the holders of at least 75 per cent of the shares voted. This would be in line with both New Zealand law and the Canada Business Corporations Act, which require the approval of a special majority of the shares voted (in New Zealand the requirement is 75 per cent of the shares voted,[42] while in Canada it is 66,6 per cent of the shares voted[43]).

In addition to the suggested increased prescribed shareholder approval of a merger, it is further submitted that the quorum of 25 per cent for the shareholders' meeting in respect of a proposed merger as provided for in the Companies Bill must be raised, perhaps to a quorum of the holders of at least 50 per cent of the eligible shares. These two measures, combined, would ensure that a more substantial and appropriate majority of shareholders approve of a merger, while at the same time remaining sufficiently liberal, permissive and flexible so as to avoid an unduly burdensome, rigid or prohibitive set of rules regulating mergers. Effectively, this proposal would

[39] See s 11.04(*e*) of the Model Business Corporation Act, 1984, as amended.
[40] See Bainbridge op cit note 9 at 624.
[41] See s 251(*c*) of the Delaware General Corporation Law, 2001.
[42] See s 221(5)(*a*) rw ss 2 and 106 of the New Zealand Companies Act, 1993.
[43] See s 183(5) rw s 2 of the Canada Business Corporations Act, 1985.

require a merger to be approved by the holders of at least 37,5 per cent of the shares of a company, which is still lower than the Delaware approval threshold of a majority of all the outstanding or issued shares of the company. This proposal would ensure a much more appropriate balance of interests between, on the one hand, the need to effect fundamental changes in a company without that being frustrated by a troublesome minority, and, on other hand, the equally important need to protect minority shareholders from oppression by the majority.

It is significant that the Companies Bill further appears to preclude shareholders from inserting in the company's Memorandum of Incorporation a stricter or a higher shareholder approval threshold for a merger.[44] Thus, even if there is a controlling or majority shareholding in excess of 50 per cent of a company's shares, the shareholders may not protect themselves by inserting in the company's Memorandum a provision that a merger will require a higher shareholder approval threshold than that provided for in the Bill. The shareholders are therefore thrown at the mercy of the majority shareholder which has the power to approve or veto any merger as it wishes. It is crucial, therefore, that the shareholder approval requirements for a merger be raised under the Bill. Provision should also be made to allow a company to do so by inserting appropriate provisions in its Memorandum of Incorporation.

A further important policy consideration is that since in a statutory merger the shareholders of the target company could receive *cash* consideration from the acquiring company (in consideration for their shares in the target company),[45] such a merger could be used to achieve a substantially similar outcome to a compulsory acquisition of the shares of the minority shareholders in a take-over offer. However, unlike the approval requirement for a compulsory acquisition of the shares of minorities, namely that the take-over offer must be accepted by the holders of at least 90 per cent of the shares to whom the offer is made,[46] a much lower level of shareholder approval suffices for a cash merger. This in itself is not necessarily problematic. But, where the shareholder approval threshold for a merger is too low, problems could arise from predators relying on the statutory-merger procedure as a way of evading the more stringent requirements of a take-over offer in order to achieve the same result. The effect could well be that investor confidence in the market would suffer from this sort of misuse or abuse of the merger procedure.[47] A proper balance has to be achieved between the need to

[44] In this regard cl 119(1) of the Bill states that '*[d]espite section 82, and any provision of a company's Memorandum of Incorporation* . . . a company may not take any steps to . . . implement a merger . . . unless it has been approved in terms of this section' [my emphasis]. Due to the reference to cl 82 of the Bill and the wide wording of this clause, there is nothing to preclude it from being used to prevent higher shareholder approval thresholds in the company's Memorandum of Incorporation.

[45] This is discussed further in par 5 below.

[46] Clause 115(1) of the Bill.

[47] See, eg, the merger in New Zealand between Waste Management New Zealand Ltd and Transpacific Industries Group Ltd in terms of which the former company was the disappearing company in a merger under which its shareholders received cash consideration. Concern was expressed by a number of market participants, including brokers and shareholders, that although the requisite special

effect mergers efficiently without minority dictation, and the need to provide effective protection for minorities.[48]

In addition to the lack of shareholder protection in the Companies Bill occasioned by the lenient quorum and shareholder approval requirements, the Bill fails to provide for any form of class voting on a merger. Separate class votes enhance the protection of the members of that class from the abuse of the power of majority shareholders and it operates effectively and quite usefully as a class veto. It is submitted that the Bill should be amended to facilitate class voting, especially in respect of preference shares that would as a result of the merger be converted into shares of the surviving company carrying different terms and preferences. Indeed, Canadian,[49] New Zealand[50] and American[51] legislation all make provision for class voting where the merger agreement contains a provision that affects the rights of that class. Surprisingly, Delaware does not protect preferred stock with a class vote.[52] The Companies Bill refers to the interests of a class of shares but only in the context of the review and approval of the merger by the court, which applies only if the merger is manifestly unfair to any class of shareholder.[53] This occurs at a much later stage of the merger process, subsequent to the adoption by the shareholders of the resolution approving the merger, and may result in the setting aside of the merger by the court.

The voting provisions of cl 119(2)(*b*) and cl 119(8) of the Bill are discussed in more detail shortly.[54]

3.2 Court Approval of Mergers

Turning to the next protective measure for shareholders, that is, the approval of a merger by the court, this is significantly not generally required

resolution to approve the merger was passed by a relatively high majority, less than half of the voting rights in the company were exercised in order to achieve the same effect as a take-over (see New Zealand Takeovers Panel *Schemes of Arrangement and Amalgamations Involving Code Companies Recommendations to the Minister of Commerce* (2006) in pars 59-60, available at *http://www.takeovers.govt.nz/publications/amalgamations* (last visited on 30 May 2007)).

[48] See Gilson op cit note 2 at 506.

[49] See s 183(4) of the Canada Business Corporations Act, 1985.

[50] See s 221(5)(*b*) of the New Zealand Companies Act, 1993.

[51] See s 11.04(*f*) of the Revised Model Business Corporation Act, 1984.

[52] This means that preference shareholders will arguably be dependent on the terms of issue of their preference shares for their protection: see Allen & Kraakman op cit note 4 at 437-8 as regards s 251 of the Delaware General Corporation Law, 2001.

[53] Clause 119(6)(*a*) of the Bill: see pars 3.2 and 15 below.

[54] Clause 119(2)(*b*) states that a proposed merger must also be approved by the shareholders of the merging company's holding company if the merger by the merging company 'substantially constitutes a parallel transaction by the holding company'. A 'parallel transaction' is undefined in the Bill. Clause 119(8) provides that any voting shares controlled by an acquiring party (which term is also not defined in the Bill) or a person acting in concert with an acquiring party are not entitled to be voted (or to be included in determining the number of shares voted in support of the resolution). Neither of these provisions has an equivalent in the merger legislation of other leading jurisdictions. Interpretations of cl 119(2)(*b*) and 119(8) are proposed in pars 6 and 8 below, in the context of triangular mergers and freeze-out mergers, respectively.

for a statutory merger. It is required only in the circumstances and the manner contemplated in cl 119(3)-(6) of the Companies Bill.[55]

First, the court's approval is required to implement a merger resolution 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 unanimously required the company to seek court approval of the transaction.[56] In these circumstances the company may either treat the resolution as a nullity or, alternatively, may apply to the court for approval, in which event the company would have to bear the costs of the application.[57]

Secondly, the court's approval is also 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.[58] 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.[59]

Where the court's approval is required under either of these two circumstances, the court may set aside the merger resolution only if, in terms of cl 119(6)(*a*), the 'resolution is manifestly unfair to any class of shareholders', or if, in terms of cl 119(6)(*b*), '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'.

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 the appraisal remedy and one must be careful not to confuse the two. The appraisal remedy is concerned with the determination of the fair value of shares in the company but does not prevent the implementation of the merger, while the exceptional requirement of court approval in terms of s 119(6) is concerned with the review of the merger resolution and the possible setting aside of the transaction. The two remedies thus provide different results and apply in different circumstances.

The requirement of court approval is considered in more detail later on,[60] with a focus on the relevant grounds in terms of cl 119(6) as well as the significance of the distinction between the appraisal right and the requirement of court approval, and the interplay between them.

3.3 The Protection of Creditors

Creditors of the merging companies obviously require protection, because after the merger the creditors of each of the merging companies would be in

[55] Clause 119(2)(*c*) of the Bill.
[56] Clause 119(3)(*a*) of the Bill.
[57] Clause 119(4) of the Bill.
[58] Clause 119(3)(*b*) of the Bill.
[59] Clause 119(5) of the Bill.
[60] See par 15 below.

competition with one another.[61] This is especially important where the proportion of the claims of a creditor of the one merging company in relation to the value of that merging company's assets is lower than the proportion of the creditor's claim in relation to the value of the assets of the merged company.[62]

Creditors' interests are protected by a number of provisions of the Companies Bill. First, the effect of the merger itself is that all the liabilities (including unknown and contingent liabilities) of the merging companies become liabilities of the surviving, merged company by the operation of law. In this way creditors' claims are not extinguished. Secondly, creditors' interests are protected by the provision that a merger may be effected only where each merged company will, upon implementation of the merger, satisfy the solvency and liquidity test.[63] Thirdly, written notice of the merger has to be given to all known creditors of the merging companies, who are entitled to object to the merger within 30 days from the date of the notice.[64] Moreover, when the merging companies perfect the merger by filing the requisite Notice of Merger with the Commissioner, the concurrent filing of a statement relating to creditors is also required.[65] It has to state that there are no reasonable grounds for believing that any creditor would be prejudiced by the merger; that adequate notice has been given to all known creditors; and that no creditor has objected to the merger, save on frivolous or vexatious grounds.[66]

The Bill itself is silent on the remedy for those creditors who do in fact object to a merger on grounds that are neither frivolous nor vexatious. Unlike the relevant legislation in, for instance, British Columbia which permits an objecting creditor to apply to the court for an order prohibiting the proposed amalgamation,[67] cl 119(3) of the Bill fails to make provision for a similar right for objecting creditors. However, it is submitted that it may be possible in appropriate circumstances for objecting creditors to rely, instead, on the oppression remedy under the Bill.[68]

The protection of creditors under the Companies Bill generally appears to be reasonable, adequate and fair. These relevant provisions are in fact comparable to the safeguards for creditors under the Canadian[69] and New Zealand[70] statutes. One important difference, however, is that in Canada and

---

[61] See Paul L Davies *Gower & Davies' Principles of Modern Company Law* 7 ed (2003) at 799.

[62] See, eg, s 223 of the New Zealand Companies Act, 1993.

[63] Clause 117(1) and (4) of the Bill.

[64] Clause 120(2); see note 33 above.

[65] As submitted in note 27 above, although cl 120(1) uses the word 'may' and not 'must', it should be regarded as a mandatory requirement or otherwise be amended pertinently so to provide.

[66] Clause 120(1)(*b*).

[67] See s 278 of the British Columbia Business Corporations Act, 2002: a creditor affected by a 'court free' amalgamation may apply to a court for an order that the proposed amalgamation not proceed. The Act makes provision in ss 276 and 277 for both amalgamations with court approval and amalgamations without court approval. For the former type, the creditors of the amalgamating company are entitled to be heard by the court in the application for an order to approve the amalgamation.

[68] Clause 164 of the Bill.

[69] See ss 185(2) and (3) of the Canada Business Corporations Act, 1985.

[70] See ss 221(4) and 223 of the New Zealand Companies Act, 1993.

New Zealand not all creditors are entitled to written notice of the merger. In Canada only those creditors with claims against the company exceeding Can$1000 are entitled to written notice, while in New Zealand only secured creditors are so entitled; all other creditors in these jurisdictions must rely on a public or newspaper notice. These provisions may be far more practical, even if only from the company's perspective, than the requirement under the Bill for written notice to be given to all creditors of the merging companies.

It is noteworthy that both the American Model Business Corporation Act and the Delaware General Corporation Law do not go as far as the Canadian or New Zealand legislation, or for that matter the Companies Bill, to protect creditors. By contrast, in England it was the controversial issue of creditor protection that led to the rejection of a 'court free' merger procedure by the Company Law Review Steering Group in 2000.[71]

3.4 The Role of the Board of Directors

Unlike legislation in Delaware[72] and New Zealand,[73] the Companies Bill does not require the board of directors of a merging company to formally adopt a resolution approving of the merger and stating or declaring that it is advisable or in the best interests of the company. Like Canadian law,[74] the Bill instead merely requires the board of directors of each merging company to consider whether the merged company would satisfy the solvency and liquidity test upon the implementation of the merger agreement and, if it does reasonably so believe, it may then submit the merger agreement for consideration at a meeting of shareholders in accordance with cl 117 of the Bill.[75]

It is nonetheless submitted that the fiduciary duties of directors, particularly the duty to act in good faith in the best interests of the company and the duty to exercise an unfettered discretion, require the directors objectively to consider whether the merger, including its terms and the merger consideration, is in the best interests of the company (that is, the shareholders) as a whole. This is especially relevant where an acquirer, in an attempt to obtain the co-operation of the board of directors of the target company, offers excessively generous side-payments to the board, for instance promising shares in the acquiring company, or employment, or a non-competition contract, or substantial severance payments.[76] It is also fundamental corporate law that at common law directors may not abuse their powers by exercising them for a collateral purpose. The common-law fiduciary duty to act in the

[71] See the Company Law Review Steering Group *Modern Company Law Review for a Competitive Economy: Completing the Structure* (Nov 2000), available at *http://www.ecdti.co.uk* (last visited on 30 May 2007) in par 11.46; Davies op cit note 61 at 801.

[72] See s 251(*b*) of the Delaware General Corporation Law.

[73] See s 221(1)(*a*) of the New Zealand Companies Act, 1993.

[74] See s 185(2) of the Canada Business Corporations Act, 1985.

[75] Clause 117(4)(*a*) and (*b*) of the Bill.

[76] See Bainbridge op cit note 9 at 648.

best interests of the company and the duty to avoid a conflict of interests are codified in cl 91 and cl 92 of the Bill.

Directors' duties in a statutory merger will also undoubtedly be further reinforced by the new Takeover Regulations that are to be drafted and enacted as part of the process of company-law reform.[77] They will apply to mergers that involve at least one widely held company,[78] and will supplement the requirement for the approval of the merger (as an affected transaction) by the Takeover Regulation Panel.[79]

Since it would be the directors of a company, and not its shareholders, that would be involved in negotiating the merger agreement, it is important that those directors that are so involved do so honestly and in the best interests of the company and that all the directors, including those not directly involved in the merger negotiations, ensure that they make a properly informed judgment on the merits and the advisability of the merger agreement. The much improved and now less subjective directors' duty of care and skill as provided for in cl 91 of the Bill, would apply to this situation**.** In this regard, the Delaware Court of Chancery stated in *Sealy Mattress Co of NJ, Inc v Sealy, Inc*[80] in relation to the duty of care that '[i]ndeed, the Supreme Court has indicated that a merger that has not been the subject of a properly informed director judgment may not be submitted to shareholders.'

When the directors do decide to submit a merger agreement for consideration at a meeting of shareholders, a notice of the meeting must be sent to each shareholder of each merging company,[81] presumably also to the holders of non-voting shares, accompanied by a copy or summary of the merger agreement and a statement of the provisions of cll 119 and 165 of the Bill relating to the prescribed shareholder approval for the transaction and the appraisal rights of dissenting shareholders. This is important as shareholders may be unaware of their appraisal rights or of how to exercise them.

The Bill does not explicitly require any further information to be furnished to the shareholders, or that any advice or recommendations be given by the directors to the shareholders. Directors' fiduciary duties[82] would arguably require that a recommendation or statement be made to shareholders on the advisability and the merits of the merger agreement.[83] Adequate disclosure to shareholders in the context of a merger is crucially important. Shareholders naturally require both sufficient and accurate information and advice on the

[77] See the *Explanatory Memorandum* to the Bill at 13.
[78] Clause 109(2)(*a*)(*iv*) of the Bill.
[79] Clause 119(2)(*d*).
[80] 532 A 2d 1324 (Del Ch, 1987), citing *Smith v Van Gorkom* 448 A 2d 858 (SC, Del, 1985).
[81] Clause 117(5) of the Bill.
[82] See MS Blackman, RD Jooste, GK Everingham, M Larkin, CH Rademeyer & JL Yeats *Commentary on the Companies Act* vol 3 (2006) at 15A 54-55 in relation to the common-law fiduciary duties of directors to inform and advise shareholders in the context of affected transactions under the current company-law regime. This is further dealt with in par 15.1 below.
[83] In this regard, s 11.04(*b*) of the American Revised Model Business Corporation Act, 1984 specifically requires the directors to transmit to the shareholders a recommendation regarding their approval of the merger.

nature and the implications of the merger for themselves, for the company, and for the company's financial and business prospects, in order to make a properly informed decision on the merits of the merger. Shareholders would also require information on the material interests of the directors in the proposed merger. The fiduciary duties of directors would most probably apply to this situation and would cover the requirements of shareholder information and advice, as would the anticipated new Takeover Regulations.[84]

In some circumstances, it would also be appropriate for directors to furnish shareholders with a report by an independent expert on the merits of the proposed merger.[85] In America, fairness opinions are in all significant merger transactions invariably obtained from investment bankers on whether the consideration to be received or paid in the merger is fair. Such opinions are used by directors as evidence of compliance with their fiduciary duties and their duty to exercise care and skill.[86] As discussed further shortly, in an interested merger where the merging parties are not necessarily at arms' length, directors would be well advised to consider certain additional matters in complying with their fiduciary duties and their duty of care and skill, such as obtaining an independent valuation of the company's shares, obtaining a fairness opinion from an investment bank to provide an independent perspective, or setting up a special committee of independent directors to which the financial and legal advisers of the company would report directly.[87]

Turning to the power of the board to terminate or amend a merger agreement *after* the approval of the agreement by the shareholders, this matter is of immense practical significance. It is common practice for merger agreements in America to contain a term to the effect that the board of directors of each merging company has the right to abandon the merger at any time before its effective date, that is, before the implementation or perfection of the merger, and to do so despite shareholder approval of the merger. Such contractual terms are useful in circumstances where, for some reason or another, the merger loses its appeal. This may occur, for instance, where there is a significant number of dissenting shareholders who exercise their appraisal rights (usually more than 5 per cent of the shareholders in terms of merger agreements) so that the resultant demands on the cash resources of the company render the merger impracticable; or alternatively where a merging company incurs substantial losses as a result of some unforeseen disaster, or where it is faced with some unexpected or material legal proceedings against

[84] See in this regard General Principle 4 and Rule 20.2 of the present Securities Regulation Code on Takeovers and Mergers, drafted by the Securities Regulation Panel in terms of s 440C of the Companies Act 61 of 1973 and published as GN R29 of 1991 in *GG* 12962 of 18 Jan1991 (hereafter referred to as the 'SRP Code').

[85] See in this regard Rule 3.1 of the present SRP Code and *Practice Note* 1/95 on Rule 3.

[86] See Kenyon-Slade op cit note 9 at 49.

[87] See further the discussion of the law in Delaware and Ontario in the context of freeze-out mergers in par 8.2 below.

it.[88] Delaware[89] as well as Canadian[90] legislation both explicitly empower the board of directors to incorporate contractual termination provisions in merger agreements, in terms of which directors may in specified circumstances abandon or terminate the merger at any time before the effective date, *regardless* of shareholder approval.

By contrast, the South African Companies Bill does not contain such a provision. It is submitted that the Bill ought to remove any doubts relating to this important issue by inserting a provision, similar to the statutory provisions in Delaware and Canada, that would empower the directors to abandon a merger at any time before it is filed regardless of shareholder approval. It should be observed, though, that such a termination of the merger would not necessarily avoid the contractual consequences of termination.

It is, likewise, of equal practical importance that amendments to the merger agreement be permitted *after* the approval of the merger agreement by the shareholders, provided, of course, that the merger has not yet been implemented or come into effect. The directors of the merging companies, in the process of negotiating and closing a merger, may find it necessary to make amendments to the merger agreement. This situation commonly arises where, after the shareholders of the one merging company have approved of the merger agreement, the shareholders of the second merging company refuse to approve the merger unless certain amendments are made to it. Where such modifications are not material, it would be useful for the directors of the former merging company to have the power to consent to such amendments, without having to incur the costs and the inconvenience of once again seeking shareholder approval of the merger agreement.

The failure of the Companies Bill to clarify the position relating to amendments of the merger agreement could result in much practical inconvenience and difficulty. It is submitted that it is advisable for the Bill specifically to permit the directors of merging companies to amend merger agreements at any time before implementation of the merger, notwithstanding prior shareholder approval of the merger agreement, provided that the amendments in question are not material. The American Model Business Corporation Act[91] and the Delaware General Corporation Law[92] both permit the inclusion of terms relating to the amendment of the merger agreement, provided that the amendments do not alter the amount or the type of merger consideration; or change the constitution of the surviving company; or materially or adversely affect the holders of any class of shares.

---

[88] See Cary & Eisenberg op cit note 18 at 1118; Robert W Hamilton *The Law of Corporations in a Nutshell* 5 ed (2000) at 629-30.

[89] See s 251(*d*) of the Delaware General Corporation Law, 2001.

[90] See s 183(6) of the Canada Business Corporations Act, 1985.

[91] In s 11.02(*e*).

[92] In s 251(*d*).

3.5 The Appraisal Right of Shareholders: An Introduction

The prime protective measure for shareholders in a statutory merger is not the sanction of the court but the appraisal right of shareholders. This is a right completely new to South African law. But it has been a feature of American law for over a century[93] and has more recently been adopted also in Canada and New Zealand.

The appraisal right may best be described as the right of a dissenting shareholder who does not approve of the merger, to have its shares bought out by the company in cash at a price reflecting the fair value of the shares, which value may be determined judicially.[94]

The formal recognition of the appraisal right of dissenting shareholders in a merger impliedly acknowledges that a merger has significant and far-reaching consequences for the shareholders of both merging companies, that is, of both the target company as well as the acquiring company. That is so as the nature of both the company as well as the shareholders' investments will change, while their rights as shareholders could also change. As will be explained in more detail later,[95] the merger procedure is not limited to 'pooling' transactions whereby both sets of shareholders of the two merging companies continue to participate as shareholders in the surviving merged company; instead, the consideration offered to shareholders of the target (or disappearing) company could consist of other securities, property, or even cash.[96] This suggests that the shareholders of the merging companies do not have the right any longer to insist on remaining as shareholders of the surviving entity, but may instead entirely be disinvested of their interests in the company and be left only with a cash consideration. As a result of these consequences for shareholders, protection in the form of the appraisal right is given to a disgruntled shareholder who disapproves of and dissents from the merger.

Appraisal also serves as an *exit mechanism* for a dissenter, in circumstances where the dissenting shareholder would otherwise pursuant to the merger be compelled to accept *shares* in a new company (that is, in the surviving merged company) in which it has no wish to hold shares. More commonly, dissenting shareholders may rely on the appraisal remedy in order to challenge and dispute the *fairness of the price offered* for their shares.[97]

But appraisal gives dissenting shareholders the right merely to claim the fair value of their shares. Such shareholders generally have no legal basis for preventing a merger that has been approved by the prescribed majority of

[93] See Allen & Kraakman op cit note 4 at 452.
[94] Ibid.
[95] See par 5 below.
[96] Clause 117(2)(*c*)-(*e*) of the Bill; see further par 5 below.
[97] See Bainbridge op cit note 9 at 632.

shareholders, save in certain exceptional and limited circumstances where the approval of the merger by the court is required.[98]

The merger procedure may thus be seen as essentially a simple and uncomplicated procedure by which companies may merge by agreement, supported by the holders of the prescribed majority of their shares, while objecting shareholders have their appraisal rights on which they can rely. As such, the merger procedure represents a substantial change in policy, which now requires some consideration.

4 Policy Issues

The new approach of permitting a statutory merger in terms of which the principle of majority rule would suffice to fundamentally change the nature of the company and the nature of the investment of all the shareholders, without the need in general for any court approval of the merger, balanced against the right of dissenting shareholders to withdraw the fair value of their shares in cash through the exercise of their appraisal rights, is patently a very significant liberalisation of policy on the part of the Legislature.

Two directly opposing or conflicting values are in issue here. On the one hand, there is a need for flexibility so that, in the interests of economic growth, companies may restructure their businesses and adapt to changing business conditions. On the other hand, there is the equally important need for shareholders to be able to retain their investments in the company, coupled with adequate protection for minority shareholders against discrimination by the majority.[99] By introducing statutory merger into our law, the Legislature has effectively and substantially shifted the balance between these two opposing values.

The new, liberal approach under the Companies Bill may be contrasted with the current, conservative, approach under the Companies Act 61 of 1973.[100] The statutory merger overrides the proprietary rights of dissenting shareholders in order to afford recognition to the general public interest of a corporate-law regime that facilitates fundamental transactions and business combinations.[101] Unlike the past, the shares of minority shareholders will now be more easily expropriated, because of the permissibility of a cash

---

[98] Clause 119(3)-(6) of the Bill, introduced in par 3.2 above and to be discussed in greater detail in par 15 below.

[99] See Gray op cit note 4 at 361; Allen & Kraakman op cit note 4 at 428.

[100] Section 440K of the Companies Act requires 90 per cent of all the shareholders to whom the bidder's offer is made, to accept the offer, in order for the bidder to be able to effect a compulsory acquisition of minorities in an affected transaction; ss 311-313 require, for a scheme of arrangement, the approval of a majority of 75 per cent of the votes exercisable by the members (or class of members) present and voting, together with the division of members into classes, the holding of separate class meetings and the sanction of the scheme by the court.

[101] See Christopher C Nicholls 'Lock-Ups, Squeeze-Outs, and Canadian Takeover Bid Law: A Curious Interplay of Public and Private Interests' (2006) 51 *McGill LJ* 407 at 409, available at *http://www.international.westlaw.com* (last visited on 30 May 2007).

consideration in a merger.[102] Shares have traditionally been recognized in our law and in other, common-law jurisdictions as proprietary rights. This is clearly illustrated in the Australian decision in *Gambotto v WCP Ltd*[103] where, in the context of the rights of the minority shareholders under an expropriation of shares, the majority judgment emphasised that a share confers proprietary rights on the holder and is more than just a capitalised dividend stream.[104] The traditional concept of shares as a form of property means that like a landowner, the shareholder ought to be able to retain his shares without the risk of compulsory divestment; although like the landowner's right, the shareholder's right cannot be absolute.[105]

The new statutory-merger provisions make great inroads into this traditional view of the shareholder's right to retain his shares. It represents a significant move away from current South African assertions, particularly in the context of expropriation by way of a scheme of arrangement under s 311 of the Companies Act, namely that in terms of the articles which under s 65(2) of that Act have contractual force as between each member and the company, 'a member is under no obligation to the company to sell or otherwise dispose of his shares at the will of any majority of the members and the company has no right co-relative to such an obligation'.[106] In short, hitherto a shareholder had a right to insist on remaining a shareholder of the company. But now the new statutory-merger provisions abandon this approach. The statutory merger similarly diverges from the current view[107] that it is questionable 'whether the members of one company can be compelled to become members of another [and that, therefore,] whatever the form of the scheme of arrangement, it would seem that where the consideration takes the form of shares in the offeror, there ought always to be a cash alternative'.[108] In the Canadian decision in *Neonex International Ltd v Kolasa*,[109] the Court saw the statutory amalgamation as a means whereby the Legislature gave the controlling shareholders the ability to expropriate the property rights of dissenting minority shareholders more easily. Under the new merger regime, appraisal

[102] See Neil Finkelstein 'Expropriation of Minority Interests and the Appraisal Remedy' (1985) 27 *Business Law Reports (Articles)* 234, available at *http://www.international.westlaw.com* (last visited on 30 May 2007).

[103] (1995) 182 CLR 432; 16 ACSR 1 (HC, Aus).

[104] The Court also acknowledged, however, that in the context of a statutory procedure for the expropriation of shares, it is assumed that Parliament had catered for adequate protection of minority shareholders' interests.

[105] See, eg, *ASIC v DB Management (Proprietary) Limited* (2000) 199 CLR 321 (HC, Aus); *Nicron Resources Ltd v Catto* (1992) 8 ACSR 219 (**, NSW); RP Austin & IM Ramsay *Ford's Principles of Corporations Law* 13 ed (2007) in par 24.350.

[106] Kunst, Delport & Vorster op cit note 21 at 603.

[107] Blackman et al op cit note 82 at 15A-27, citing *Re Hunter Resources Ltd* (1992) 7 ACSR 436 (FC of Aus).

[108] Blackman et al op cit note 82 at 15A-27. This principle will no longer be applicable under the statutory-merger procedure, particularly where the holders of 75 per cent of a company's shares approve a merger resulting in the denial of appraisal right to any dissenting shareholders: see par 12 below).

[109] [1978] 2 WWR 593, 3 BLR 1 (SC, BC).

rights may therefore be seen as a shield protecting shareholders from the arbitrary expropriation of their shares.[110]

This shift in policy in favour of the adoption of appraisal rights may be seen as a substitution of liability rules for the previous property rules.[111] It abandons the idea that shareholders possess 'vested rights' in the form of their investment, and instead establishes the new approach that 'shareholder interests are held subject to the exercise of collective shareholder judgment'.[112]

This policy shift follows similar trends in America,[113] trends also adopted in Canada and New Zealand. However, it does represent a radical departure from South Africa's traditional and historical adherence to English company law, similar to the departure from English law that took place in Canada and New Zealand when these jurisdictions opted to adopt the American-type approach to mergers.[114] In this regard, neither English[115] nor Australian law has adopted a statutory-merger procedure that bypasses the requirement of court approval but have instead retained the traditional conservative approach along the lines of that current contained in the South African Companies Act.

The new statutory-merger procedure under the Companies Bill will facilitate business combinations and fundamental transactions far more effectively than does the current regulation by the Companies Act. Indeed, take-overs and fundamental transactions in general are increasingly seen as being beneficial to corporate efficiency, to the economy, and to wealth creation, because a failure by directors to run a company efficiently, as reflected by underperforming share prices, renders the company an easy prey for a take-over by more a efficient management, with the consequent improved allocation and use of resources in the market.[116] The regulatory emphasis is now on attaining the appropriate balance of the interests of all the shareholders, so as to avoid either minority oppression by the majority, or minority dictation which enables recalcitrant minorities perversely to prevent the improved management of a company that could result from a merger.

While the approach in the Bill to mergers is, to this extent, in line with foreign trends and the underlying policy of harmonisation of South African law with other leading jurisdictions, it is respectfully submitted that further attention ought to be given to the balance that the Bill attempts to achieve between minority oppression by the majority and minority dictation. It is submitted that in several respects the Bill is weighted much too heavily in

---

[110] Finkelstein op cit note 102.

[111] Buckley, Gillen & Yalden op cit note 8 at 1001.

[112] Allen & Kraakman op cit note 4 at 452.

[113] See, eg, idem at 427-9.

[114] Grantham & Rickett op cit note 4 at 38-9; see also Buckley, Gillen & Yalden op cit note 8 at 1001.

[115] In England a court-free statutory merger was considered but rejected due to the problems which the statutory merger poses in relation to the protection of creditors and the rights of third parties in terms of agreements with one of the merging companies: see the Company Law Review Steering Group op cit note 71 in par 11.46; Davies op cit note 61 at 801.

[116] See, eg, the Commonwealth of Australia Corporate Law Economic Reform Program's Proposals for Reform, Paper No 4, *Takeovers* (1997) at 7; Austin & Ramsay op cit note 105 in par 23.080.

favour of the majority, and does not go far enough to protect minority shareholders from oppression by the majority. This approach of under-protecting the minority not only underlies the shareholder approval requirements, which as explained are much too lenient, but also underlies other aspects of the Bill, in particular the appraisal right. Paradoxically, however, the Bill does provide strong minority protection in the context of an interested (or non-arms' length) merger.[117]

A further policy issue is that the Companies Bill does not discard the scheme-of-arrangement procedure as a method of effecting fundamental transactions, but instead makes provision for both the statutory merger as well as a scheme of arrangement. This follows Canadian and New Zealand law which also permit the use of both types of procedure for effecting a fundamental transaction. South African companies consequently would now have an additional mechanism to achieve business combinations, over and above the existing methods such as the take-over offer with compulsory acquisition of minorities, the scheme of arrangement, and the sale of the business of the company.[118] As stated in the *Explanatory Memorandum* to the Bill, this approach is intended to create more flexibility for companies and to enhance efficiency in the economy.[119] This approach is to be welcomed. Where companies are provided with different methods for effecting fundamental transactions, each method having its own particular nuances, protections, advantages and disadvantages, it only serves to accommodate differing circumstances and needs.

Like the scheme of arrangement, the statutory-merger procedure is suited more to friendly or recommended transactions, where the board of directors of the target company co-operates with the acquiring company both in negotiating the terms of the merger and in recommending the merger to the shareholders, rather than to hostile transactions where the take-over offer is more appropriate.[120] Significantly, the Bill effects substantial changes to the traditional scheme-of-arrangement procedure. In particular, the traditional requirement that a scheme of arrangement must be judicially sanctioned is replaced with appraisal rights for dissenting shareholders, and furthermore the prescribed shareholder approval requirements for a scheme of arrangement are to be aligned with those for the statutory merger along with the abolition of separate class voting.

[117] More on this in pars 8 and 9 below.

[118] See cll 116 and 119 of the Bill on the disposal of substantially all the assets or the undertaking of a company. Clause 119 of the Bill requires only a simple majority vote of the shares voted at a meeting at which the holders of at least 25 per cent of the shares entitled to be voted are present, and stands in stark contrast to s 21 of the Corporate Laws Amendment Act 24 of 2006 (which came into effect on 14 Dec 2007: see Procl 47 of 2007 in *GG* 30594 of 14 Dec 2007) which amends s 228 of the Companies Act 61 of 1973 to the effect that a special resolution (and no longer an ordinary resolution) is required for the disposal of the whole or greater part of the assets or undertaking of a company.

[119] See the *Explanatory Memorandum* op cit note 77 at 13.

[120] See Christopher A Iacono 'Tender Offers and Short-Form Mergers by Controlling Shareholders under Delaware Law: The "800-Pound Gorilla" Continues Unimpeded – *In Re Pure Resources, In., Shareholders Litigation*'(2003) 28 *Delaware J of Corporate Law* 645 at 650. See cl 118 (and cl 119) of the Bill for the relevant provisions on schemes of arrangement.

Although a detailed analysis of the scheme of arrangement is beyond the scope of this paper, it is respectfully submitted that the amendments proposed by the Companies Bill to the scheme-of-arrangement procedure may well be ill–advised. The traditional court-approved scheme of arrangement ought to be retained in our law. This would harmonise South African law with Canadian and New Zealand law, both of which provide for both a 'court-free' statutory merger as well as a court-approved arrangement procedure. In Canada[121] and in New Zealand,[122] even where the statutory merger would be appropriate in a particular case, companies may still opt to rely instead on the court–approved arrangement procedure to effect a fundamental transaction. Companies might prefer to do so, for instance, where the envisaged transaction is complex and multi-layered with the result that the approval of the court could be relied on by the board of directors as an additional layer of review and protection,[123] or, alternatively, where the merging companies are illiquid and accordingly wish to avoid the cash drain attendant upon the exercise of appraisal rights by dissenting shareholders in a statutory merger.

It may furthermore be suggested that South African law ought to retain the traditional court-approved scheme of arrangement, but that in order to modernise it and to create greater flexibility the Companies Bill ought to grant wider powers and a wider discretion to the court so as to render the court–approved scheme-of-arrangement procedure less prescriptive. The New Zealand approach may be used as a basis or template. It has the merits of giving the court wide discretionary powers to enable it to make a wide range of orders, including an order to convene a meeting of shareholders or separate class meetings, or to request a report on the arrangement. Courts in New Zealand also have the discretion to specify who is entitled to be heard in the application for approval of the arrangement by the court and to make an appropriate order providing for dissenting shareholders.[124]

Having discussed the concept of the statutory merger in general, I will now turn to the various permissible forms of merger structure under the Companies Bill, including the triangular merger, the reverse triangular merger, and the freeze-out merger, together with the appropriate circumstances in which they may be used and their attendant advantages and disadvantages.

---

[121] See s 192(3) of the The Canada Business Corporations Act, 1985 which provides that an acquisition may be effected by a court-supervised arrangement where it is not practicable to do so using the amalgamation procedure, in other words, where it is not practicable to effect the acquisition without judicial assistance. However, it was recently confirmed in Alberta that under s 193 of the Alberta Business Corporations Act, 2000 (c B-9), the impracticability threshold is low: see *PetroKazakhstan Inc v Lukoil Overseas Kumkol BV* 2005 ABQB 789 (QB, Alta) in par 27.

[122] See s 238 of the New Zealand Companies Act, 1993.

[123] See WJ Braithwaite & JJ Ciardullo [of Stikeman Elliott LLP, Toronto] *Mergers and Acquisitions in Canada*, available at *http://www.stikeman.com* (last visited on 30 May 2007).

[124] See ss 236 and 237 of the New Zealand Companies Act, 1993; see also s 192 of the Canada Business Corporations Act, 1985.

5 Merger Structures: General

The Companies Bill not only envisages the traditional concept of a merger as a 'pooling' type transaction – in terms of which the two sets of shareholders of the two merging companies continue to participate as shareholders in the surviving merged company, which holds the combined pool of assets and liabilities previously held severally by the two merging companies – but also envisages other types of merger structure. This is apparent from the different forms of merger consideration permitted by the Bill.

The purpose of the merger agreement, as explained earlier, is to set out the terms of and the means of effecting a merger. The merger agreement must deal with certain specified matters such as the names of the proposed directors of the surviving merged company and the details of any necessary arrangements to complete the merger. It must also provide for the subsequent management and the operation of the surviving merged company. In the case of an amalgamation, the merger agreement must deal with the Memorandum of Incorporation of the newly amalgamated company. The merger agreement also sets out the manner in which the shares of each constituent merging company are to be converted into shares or other securities[125] of the surviving company, or to be exchanged for other property.[126]

It is noteworthy that where any shares of one merging company are held by the other merging company, the merger agreement must provide for such shares to be cancelled on the effectuation of the merger, without repayment of capital. Furthermore, such shares cannot be converted into shares of the surviving merged company.[127] This is comparable to Canadian[128] and New Zealand[129] legislation. The reason for this is that the merged company would otherwise effectively hold shares in itself, and the merger would effectively result in an indirect reduction of the capital of the merged company.[130]

The merger consideration under the merger agreement is usually or effectively paid to the shareholders of the target or disappearing company, in consideration for their shares in the target company. The statutorily permissible types of consideration is an important issue as it determines the scope of the merger procedures and the permissible structures of the merger.

First, the provisions of the Companies Bill are not confined merely to the traditional 'pooling' type merger, where the consideration payable to the shareholders is in the form of *shares* in the surviving merged company. They also permit the issue of other securities such as debentures or notes of the merged company, or the exchange of any 'other property' as consideration.[131] Where the consideration payable to the shareholders in the target or

[125] As defined in s 1 of the Securities Services Act,36 of 2004.
[126] Clause 117(2)(*c*) of the Bill.
[127] Clause 117(3) of the Bill.
[128] See s 182(2) of the Canada Business Corporations Act, 1985.
[129] See s 220(30 of the New Zealand Companies Act, 1993.
[130] See Gray op cit note 4 at 334.
[131] Clause 117(2)(*c*) of the Bill.

disappearing company consists of shares in the acquiring or surviving company, the shares of the target company are automatically *converted* by the operation of law into shares of the acquiring company on the implementation of the merger agreement.[132]

Secondly, a *cash* consideration is permissible,[133] and the relevant provisions on this possibility are quite liberal. In many other jurisdictions a cash consideration is subject to stringent restrictions, such as in the Netherlands where a cash payment is limited to no more than 10 per cent of the consideration,[134] and in Norway where at least 80 per cent of the consideration is required to take the form of shares.[135] Even in Delaware, the leading American jurisdiction for the incorporation of companies, despite the state's longstanding use of the merger procedure, consideration in the form of cash has been permitted only since 1967. Under the American Model Business Corporation Act, too, it has been permitted only since 1969.[136] Both Canadian[137] and New Zealand[138] law now permit cash mergers.

The implication of paying a cash consideration to the shareholders of the disappearing company is that they do not have a vested right to continue to hold their investment as shareholders of the surviving merged entity, but could instead be 'cashed-out' and could thereby be compelled to disinvest from the company. A cash merger may consequently be said to be more in the nature of a sale, as opposed to the traditional concept of a merger as a 'pooling' transaction.[139] More importantly, a cash merger creates a definite scope for the use of the statutory-merger procedure as a means to squeeze-out or eliminate the minority shareholders of a company, by compelling them under the merger agreement to exchange their shares for cash.[140]

Thirdly, a final type of merger consideration in terms of the Companies Bill consists of shares in *another company* other than the surviving merged company. Although in the context of merger consideration, the Bill refers only to the conversion of shares of a constituent merging company into shares of the merged company without extending this to the conversion of the shares into shares of *any other* company, the term 'other property' in cl 117(2)(*c*) read together with cl 117(2)(*e*) may be interpreted to include the issue of shares of *another company* as a merger consideration. In this regard, cl 117(2)(*e*) envisages the issue of (fractional) shares of a 'merged company or

---

[132] As suggested by the wording of cl 117(2)(*c*) and (*e*). See also Bainbridge op cit note 9 at 628.

[133] Clause 117(2)(*d*) of the Bill.

[134] See art 2:325 of the Dutch Civil Code, Book 2, as reproduced in L Timmerman & A Doorman 'Rights of Minority Shareholders in the Netherlands', available at *http://www.ejcl.org/64/art64-12.doc* (last visited on 30 May 2007) at 206.

[135] See the Norwegian Public Limited Companies Act (Allmennaksjeloven, 13 Jun 1997, no 45), ch 13, referred to and available at *http://crossborder.practicallaw.com/0-202-2788* (last visited on 30 May 2007).

[136] Kenyon-Slade op cit note 9 at 28; see also s 251(b)(5) of the Delaware General Corporation Law, 2001.

[137] See s 182(1)(*d*) of the Canada Business Corporations Act, 1985.

[138] See s 120(1)(g) of the New Zealand Companies Act, 1993.

[139] See Clark op cit note 16 at 435.

[140] See further par 8 below.

of *any other body corporate the securities of which are to be received*'[141] in the merger. The important significance of a merger consideration in the form of shares in another company is that is that it facilitates a triangular merger structure.[142] The consideration in a triangular merger frequently consists of shares in the *holding* company of the surviving merged company. The triangular merger is a very popular form of merger structure in those jurisdictions that permit it. It, too, represents a fairly liberal approach which, like the cash merger, was not permitted in Delaware until as late as 1967.[143] It is regrettable that the wording of the Companies Bill on this issue leaves some room for doubt. It is submitted that the Bill ought to put it in clear and unambiguous terms that the triangular merger is permissible in South African law.[144]

Numerous factors influence or affect the choice of the merger consideration. These may include the tax consequences associated with each type of consideration; the requirements of the target company shareholders; the acquiring company's financial resources and liquidity, which may determine the desirability of cash consideration; and the anticipated impact on the market price and the dilution of the acquiring company's shares that is associated with the merger consideration in the form of shares in the acquiring (or surviving) company.[145]

Several popular merger structures associated with these various types of consideration may now be discussed in more detail.

6 The Triangular Merger

6.1 Structure and Purpose of the Triangular Merger

As its name suggests, the triangular merger involves three companies, two of which are in a holding and subsidiary company relationship.[146] On the target side of the transaction is the target company (Company T), while on the acquiring side of the transaction are two companies, the holding company (Company H) which is the would-be acquirer in the transaction, together with its newly-formed, wholly-owned subsidiary (Company S). Company S is invariably a newly-formed shell company which is formed specifically for the purposes of the merger. It functions as a vehicle of acquisition in the merger with the target company, so that technically, it is the *subsidiary of the*

[141] My emphasis.
[142] See par 6 below.
[143] See Kenyon-Slade op cit note 9 at 28; s 251(*b*)(5) of the Delaware General Corporation Law, 2001.
[144] See, eg, the wording of s 182(1)(*d*) of the Canada Business Corporations Act, 1985 and s 251(*b*)(5) of the Delaware General Corporation Law, 2001.
[145] Practical Law Company [PLC] *Cross-Border Handbooks Mergers and Acquisitions 2006/7* 7 ed (2006) at 436-7.
[146] See Bainbridge op cit note 9 at 629; Clark op cit note 16 at 430.

would-be acquirer that is directly a party to the merger and *not the would-be acquirer* itself.

The object of a triangular merger is that upon implementation of the merger, the *target* company, Company T, becomes *Company H's wholly-owned subsidiary*. In this regard, in the merger of Company T into the *shell* wholly-owned subsidiary Company S, Company T is the disappearing company, with the result that consequent upon the merger Company T is effectively absorbed by or 'housed' in Company S, and thus the business of Company T effectively becomes the business of the wholly-owned subsidiary of Company H. This triangular merger structure enables Company H to conduct the newly acquired business of Company T in a separate legal entity.[147]

The triangular merger may be contrasted with the standard type of merger, in terms of which the disappearing or target company fuses *directly* with the would-be acquirer, and is engulfed by or absorbed into the would-be acquirer.

The consideration receivable by the shareholders of Company T is a crucial issue. Pursuant to the triangular merger, the shareholders of Company T receive (as consideration for their shares in Company T) either cash or shares in Company H. It must be emphasised that the shares are *in Company H, and not in Company S*. As submitted earlier, the Companies Bill does envisage merger consideration in the form of shares in a company other than that of the surviving merged company, such as Company H. The end result of the triangular merger, consequently, is that Company S remains in existence as the surviving merged company, holding all the assets and liabilities formerly held by Company T, and continuing to remain *a wholly-owned subsidiary of Company H*. Depending on the form of the merger consideration, the former shareholders of Company T either become shareholders in Company H or are entirely cashed out.[148] Thus, in substance although perhaps not in form, the outcome of the triangular merger is that Company T becomes a wholly–owned subsidiary of Company H.

A complication associated with the triangular merger is that, as the acquiring company is technically Company S and not Company H, it is Company S and not Company H which ought to pay the merger consideration to the shareholders of Company T. In America this is accomplished in practice by Company H capitalising Company S with the requisite merger consideration (be it cash or shares in Company H) at some stage prior to the merger, technically in exchange for the issue to Company H of all the shares in Company S upon which Company S becomes the wholly-owned subsidiary of Company H.[149]

Importantly, there may be limitations in South African law on the use of the shares of Company H as the consideration in a triangular merger, in view of

[147] See Gilson op cit note 2 at 529; Clark op cit note 16 at 430.
[148] See Pinto & Branson op cit note 11 at 122-3; Gilson op cit note 2 at 629.
[149] See Bainbridge op cit note 9 at 629; Clark op cit note 16 at 430-1.

the limitation that a subsidiary company may not acquire shares in its holding company in excess of 10 per cent in the aggregate of the number of issued shares of the holding company.[150] This could mean that the maximum permissible consideration in the form of shares in Company H (which Company H would have to issue *via Company S* to the shareholders of Company T) would have to be limited to no more than 10 per cent of the issued shares in Company H.

Then, again, it could be argued that in a triangular merger it is permissible for Company H itself to pay the merger consideration,[151] and accordingly for Company H to issue its shares *directly* to the shareholders of Company T, as opposed to doing so *indirectly* via Company S, and so to avoid the problem of a prohibited acquisition of shares by a subsidiary company in its holding company. Such an argument would be supportable in view of the fact that the Bill, otherwise than under American legislation, requires not only the shareholders of Company T and Company S, but also the shareholders of Company H, to vote on and to approve of a triangular merger.[152]

Regarding the position in South African law on the use of *cash* as consideration in a triangular merger, as explained above, Company S, which is a shell company, obtains the cash from Company H, ostensibly as the issue price for the issue to Company H of 100 per cent of the shares of Company S. Although this may arguably amount to the giving of financial assistance by Company H to Company S, it does not fall within the ambit of s 38 of the Companies Act or cl 40 of the Bill as such financial assistance is not for the prohibited purpose, namely for the purchase or subscription of shares in Company H under s 38 or the purchase of shares in Company H or a related or inter-related company under cl 40.[153]

The triangular merger is a welcome procedure in our law and South African companies would, no doubt, consider it useful. It enables the would-be acquirer, Company H, to manage the business of the newly acquired Company T in a separate wholly-owned subsidiary company. The advantages of this are twofold. First, neither Company H nor Company T has to disappear under the merger, as is usually the case in a standard two-party merger where one merging company must be the disappearing company.[154] The acquired company's business, customer relationships and goodwill may accordingly be maintained substantially intact and unchanged in the acquisition vehicle, that is, in the shell subsidiary. This is especially convenient where the businesses of Company H and the acquired company, that is Company T, are of different natures and are best kept separate and distinct. The second major advantage of

---

[150] See s 89 of the Companies Act, 61 of 1973, as amended, and cl 51(1) and (2) of the Bill.

[151] In the form of shares in Company H, which is permissible merger consideration in terms of cl 117(2)(*c*) rw (*e*) of the Bill as stated in par 5 above. Clause 37 of the Bill provides that a company may issue shares for consideration or other benefit to the company. The benefit to Company H is discussed shortly.

[152] See further par 6.2 below.

[153] See further *Lipschitz NO v UDC Bank Ltd* 1979 (1) SA 789 (A).

[154] See Gilson op cit note 2 at 530.

the triangular merger is that it enables Company H to ring-fence Company T's liabilities in a separate legal entity, including, most importantly, any unknown and contingent liabilities. This reduces Company H's exposure to liability pursuant to the merger, and effectively neutralises one of the distinct disadvantages associated with the standard two-party merger.[155]

Indeed the triangular merger may be regarded as even less controversial than the standard two–party merger, as one of the constituent merging companies in a triangular merger is a *shell* or 'clean' company, with the result that pursuant to the merger the surviving, merged company will have exactly the *same* assets and liabilities which the acquired or target company had prior to the merger. Consequently, compared with a two-party merger, the triangular merger carries a lower risk of prejudice to the rights of creditors or other third parties under contracts with the target company.[156]

6.2 Shareholder Voting on a Triangular Merger

In America a strong practical reason for the popularity of the triangular merger structure is the denial of voting and appraisal rights to the shareholders of the would-be acquirer, Company H. As the constituent merging companies in a triangular merger are technically and formally only Company T and Company S – and not also Company H – the shareholders of Company H have no right to vote on or veto the merger. Moreover, the vote of Company S on the issue of the triangular merger is a non-contentious matter, since Company H, as the holding company, is the sole shareholder of Company S. In America the triangular merger is used by companies to their advantage, to avoid the costs of convening a shareholder meeting (of the would-be acquirer, Company H) and more importantly, to avoid the appraisal rights of their shareholders.[157]

It is nevertheless submitted that this denial of both voting and appraisal rights to the shareholders of Company H in a triangular merger is both inappropriate and unsatisfactory.[158] This is so on a number of grounds. First, as stated above, Company S is invariably a *shell* company, formed by the would-be acquirer, Company H, for the purpose of the merger with Company T. Secondly, Company H is in substance and *effectively* the actual acquirer, and the merger is effectively financed with the cash or the shares of Company H. Thirdly, the triangular merger has a direct impact on the shareholders of

[155] See Bainbridge op cit note 9 at 630; Gilson op cit note 2 at 529.

[156] See Davies op cit note 61 at 801. Although the Company Law Review Steering Group in the UK concluded that a court-free statutory-merger procedure would generally be impractical, it found that one exceptional situation in which such a procedure would be feasible was the merger of a wholly-owned subsidiary (of a holding company) with an existing company. It was reasoned that in such cases the transferee company would be a 'clean' company: see the Company Law Review Steering Group op cit note 71 in par 11.47; and Company Law Review *Modern Company Law for a Competitive Economy: Final Report* Vol I (Jul 2001) URN 01/943 in par 13.13-13.15, referred to in Davies op cit note 61 at 801.

[157] See Gilson op cit note 2 at 530.

[158] See, eg, Cary & Eisenberg op cit note 18 at 1156.

Company H: if the merger consideration payable to the former shareholders of Company T is in the form of shares in Company H, this results in a dilution of the shares of Company H; while if the merger consideration is cash (which emanates from Company H, as explained above), this may impact on the dividends payable to the shareholders of Company H. Consequently, the shareholders of Company H ought on these grounds to be entitled not only to vote on the triangular merger, but also to appraisal rights.

Significantly, in this regard, the Companies Bill provides that a merger must be approved by the shareholders of the company's holding company, if any, if the transaction by the first company substantially constitutes a parallel transaction by the holding company.[159] The phrase 'parallel transaction' by the holding company is unfortunately not defined in the Bill. There is also no comparable provision in the merger legislation of any of the leading jurisdictions on this matter which would assist in the interpretation of the phrase. The meaning and the purpose of this provision is consequently and regrettably, unclear. It ought certainly to be defined in the Bill.

It may be suggested that by a parallel transaction by the merging company and its holding company, the Legislature most probably intended to refer to a triangular merger by which the transaction by Company S amounts to a simultaneous, corresponding or 'parallel' transaction by Company H. In other words, the merger is formally an acquisition of Company T by Company S, but is substantively an acquisition of Company T by Company H, and therefore the merger to this extent constitutes substantially a 'parallel transaction by the holding company'. Whether it amounts to a parallel transaction regardless of whether the triangular merger consideration consists of cash or of shares in Company H, is unclear. But it is submitted that no distinction ought to be drawn, as in either case it is Company H which effectively finances the merger consideration.

On the assumption that this understanding of a 'parallel transaction' is correct, the voting provisions of the Bill, unlike those in America, give to the shareholders of the *holding company* in a triangular merger the right to vote on the merger as well as to exercise their appraisal rights should they dissent.[160] This, it is submitted, is without doubt a commendable step in the right direction. It avoids the potential for unfairness to the shareholders of the would-be acquirer that presently exists under both the American and the Canadian statutory provisions on triangular mergers. It also echoes s 21(2) of the Corporate Laws Amendment Act, 24 of 2006 which amends s 228 of the Companies Act to the effect that a special resolution by the shareholders of a *holding company* is required for the disposal by a *subsidiary* of its undertaking or the whole or greater part of its assets, where such disposal by the subsidiary would constitute a disposal by the holding company in relation to its consolidated financial statements.

---

159 Clause 119(2)(*b*) of the Bill.
160 Clause 119(7) of the Bill.

Even if the interpretation of a 'parallel transaction' suggested above is inapplicable in these circumstances, there is a further safety-net for the shareholders of the holding company in a triangular merger. Under certain circumstances[161] cl 38(4)(*b*) of the Bill requires a *special resolution* by shareholders for the issue of shares in a transaction where the voting power of such shares would comprise more than 30 per cent of the voting power of all the issued shares of the company immediately before the transaction. There is no reason in law why this provision should not be extended to a triangular merger transaction, to require a special resolution by the shareholders of *Company H* where the consideration payable to the shareholders of Company T in consideration for their shares in Company T is in the form of shares in Company H and amounts to more than 30 per cent of the voting power of the issued shares of Company H immediately before the merger. (The Company H shares will, in accordance with cl 38(4)(*b*), be issued in these circumstances for a consideration other than cash, regardless of whether they are issued via Company S to Company T, or directly to Company T.[162] The provisions of the Model Business Corporation Act,[163] the rules of the New York Stock Exchange,[164] the American Stock Exchange,[165] and those of the NASDAQ Stock Market[166] are all of a similar effect.

(To be continued.)

---

[161] Provided that the shares are issued for consideration other than cash or cash equivalent or for less than fair market value.

[162] The permissibility of this form of merger consideration would, of course, also be subject to the application of the limitation on the acquisition of shares by a subsidiary in its holding company in terms of cl 51 of the Bill, as discussed in par 6.1 above.

[163] See s 6.21 of the Model Business Corporation Act, as amended, which gives shareholders the right to vote on any transaction that increases the number of shares issued by the corporation if the new shares carry 20 per cent or more of the voting power and are issued other than for cash. This rule has the effect that the shareholders of the parent company in a triangular merger will have the right to vote if the transaction involves an increase in voting power of 20 per cent or more of the parent company: see Hamilton op cit note 88 at 633.

[164] See the NYSE Listed Company Manual Rule 312.03.

[165] See the AMEX Company Guide Rule 712(*b*).

[166] See the NASDAQ Stock Market Rule 4310(*c*)(25)(H)(*i*).