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**AMALGAMATIONS AND THE INTRODUCTION OF A
STATUTORY MERGER IN THE NEW COMPANIES ACT 71 OF
2008: AN ANALYSIS OF THE PROCEDURE AND REMEDIES
BROUGHT ABOUT BY THE INCLUSION OF THESE TWO
CONCEPTS**

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I hereby declare that I have read and understood the regulations governing the submission of LLM dissertations, including those relating to length and plagiarism, as contained in the rules of this University, and that this dissertation conforms to those regulations.

24 February 2011

Signed by candidate

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CHAPTER 1-Introduction

Introduction

The introduction of the new Companies Act 71 of 2008 has brought about many reforms and regulations to assist present and soon to be incorporated companies. The legislature's sole aim is to provide a functioning stable economic environment for companies in South Africa whilst providing adequate security and remedies for all shareholders and stakeholders. The new Companies Act establishes a, Companies and Intellectual Property Commission as well as a Takeover Regulation panel to ensure that the requirements of the Act are administered correctly.

I will look at the significant impact on merger and acquisition ("M & A") activity in South Africa as this is the first time that a statutory merger will be introduced into South African law. A concept that is giving more emphasis in the new is that of an amalgamation. An amalgamation and merger is governed by Chapter 5 of the new Act. This paper aims to establish the difference between a 'merger' and an 'amalgamation' and what procedures as well as any other forms of compliance (such as Competition Law) each of the above has to adhere to. The paper will then focus on the issues brought about by the introduction of these concepts including shareholder rights, more specifically appraisal rights and the appraisal rights procedure; contract law and mergers; amendments to other legislation; protection of creditors; the preventing of an amalgamation or merger and the procedures for the different stages for implementing a merger or amalgamation.

The pitfalls and benefits of each procedure and remedy will be highlighted. I will then conclude by suggesting what needs to be improved or replaced and my general opinion on the merger provisions. This chapter seeks to establish a basic understanding of the difference between an amalgamation and a merger. I will look at the Companies Act 61 of 1973, the new Companies Act 71 of 2008 and the Competition Act 89 of 1998 with regards to mergers and acquisitions as well as amalgamations. Definitions from the Companies Bill ('the Bill') will also be analysed.

I would at this stage like to emphasize that as the new Companies Act has not been implemented at the time of writing of this paper. Resources and materials on the provisions in the new Act are fairly limited. It is unclear whether the new Act will in fact come into force in April 2011 due the amendments. Many procedural aspects of the Act will only tested once the Act comes into force.

Chapter 1 will seek to set a basis by stating the relevant definitions, whilst also discussing the legislative process of the provision in Chapter 5 of the new Act pertaining to mergers and amalgamations, whilst chapter 2 will set about analysing the other provisions within the chapter. Chapter 3 defines and discusses the newly added concept of a statutory merger into our law as well as its procedure. Chapter 4 will look at the procedural aspects of section 115 and 116 respectively and set out any problems within its provisions. Chapter 5 will look at the situation of contracts during and after the merger or amalgamating process. Chapter 6 and 7 is dedicated to shareholders. Those chapters will analyse the remedies and processes available to a shareholder. It will also discuss the much anticipated appraisal remedy. In chapter 8 I will give my own opinion and those of others on what needs to be improved and my general view of the provisions. I have used many chapters to highlight the various topics so it is much easier to see the differences.

1.1) Definitions of a merger and an amalgamation in South Africa

The Companies Act 61 of 1973 and the Competition Act 89 of 1998 do not define an 'amalgamation'. A merger is defined under section 12(1) of the Competition Act as the 'direct or indirect acquisition or direct or indirect establishment of control by one or more persons over all significant interests in the whole or part of the business of a competitor, supplier, customer or other person, whether that control is achieved as a result of—(a) purchase or lease of the shares interest, or assets of that competitor, supplier, customer or other person; (b) amalgamation or combination with that competitor, supplier, customer or other person: or (c) any other means'.

The Companies Act 71 of 2008 (which for brevity, will sometimes be referred to in what follows as 'the new Companies Act' or 'the new Act') seeks to provide clarity

in this regard so as to avoid any possible confusion between a ‘merger’ and an ‘amalgamation’. Whether in fact this distinction has been achieved will be discussed further in the chapter. The new Act therefore provides definitions to distinguish between the two types of structures. The legislatures saw it fit to place the definition of an amalgamation and merger within section 1 of the new Act instead of providing separate definitions under the relevant sections within Chapter 5. The present Companies Act does not provide for a merger where two corporate entities amalgamate into a single entity.¹

The new Companies Act has the following definitions:

“‘**amalgamation or merger**’ means a transaction, or series of transactions, pursuant to an agreement between two or more companies, resulting in— (a) the formation of one or more new companies, which together hold all of the assets and liabilities that were held by any of the amalgamating or merging companies immediately before the implementation of the agreement, and the dissolution of each of the amalgamating or merging companies; or (b) the survival of at least one of the amalgamating or merging companies, with or without the formation of one or more new companies, and the vesting in the surviving company or companies, together with such new companies, of all of the assets and liabilities that were held by any of the amalgamating or merging companies immediately before the implementation of the agreement; ‘**amalgamated or merged company**’ means a company that either— (a) was incorporated pursuant to an amalgamation or merger agreement; or (b) was an amalgamating or merging company and continued in existence after the implementation of the amalgamation or merger agreement, and holds any part of the assets and liabilities that were held by any of the amalgamating or merging companies immediately before the implementation of the agreement; ‘**amalgamating or merging company**’ means a company that is a party to an amalgamation or merger agreement...”²

The definition introduces two types of structures: an amalgamation and a merger. In the Companies Bill³ (the Bill), definitions were provided for both an amalgamation and a merger. A merger was 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’⁴. On the other side, an amalgamation was 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

¹ Ezra Davids and David Yuill ‘Getting the Deal through - Mergers & Acquisitions 2010’ 2010 *Law Business Research Ltd*. Pg 269-273 at 269.

² Companies Act 71 of 2008 sec 1

³ GN 166 of 2007 in GG 29630 of 12 Feb 2007

⁴ Clause 1 of the Bill.

and liabilities previously held by the several amalgamating companies'.⁵ This provides a clear distinction between the two forms of transactions. The first structure, in terms of the Bill, involves two companies (constituent companies) that fuse into a new company. As a result the 'constituent companies' are dissolved and the new company acquires all the assets and liabilities of the previous companies.⁶ The second structure is when one of the constituent companies fuses into another company. The result being that one of the constituent companies survives and the surviving company acquires all the assets and liabilities of the previous companies.⁷

Cassim provides an example as to how these two structures vary:

... where an acquiring company, Company A, and a target company, Company T, wish to merge, both Companies A and T are dissolved and a new company, Company N, is created. By contrast, in the second structure, Company A survives and continues in existence, while Company T disappears and is dissolved or deregistered. Accordingly, the first structure results in the fusion of all the constituent companies into a new company, while the second structure results in the fusion of one constituent company into the other...⁸

From the definition of the new Act, it can be shown that a 'merger is a transaction or series of transactions which results in one or more companies holding all the assets and liabilities previously held by the several merging companies'.⁹ Two important consequences appear as a result of the definition above. The first being that 'all of the assets and liabilities of the merging companies are transferred to the new merged entity takes place by operation of law and parties would therefore not be able to use the procedure to transfer only part of a company's business'¹⁰, which means that those parties wanting to sell a part of the business would have to do it via an asset or business sale with reference to sections 112 and 115 of the new Act. Those parties in turn would not have the benefit of an automatic transfer of obligations and rights which usually take place in accordance with a merger.¹¹

⁵ Clause 1 of the Bill.

⁶ Maleka Femida Cassim. 'The statutory merger in South African law'. *Juta's Business Law*, Vol 16, Issue 2. 2008. Pg 40-42 at 41.

⁷ *Ibid.*

⁸ Cassim op cit note 5 at 42.

⁹ *Ibid.*

¹⁰ Ezra Davids, Trevor Norwitz & David Yuill. 'A Microscopic Analysis of the New Merger and Amalgamation Provision in the Companies Act 71 of 2008: Corporate Governance and Mergers & Takeovers: Part II'. 2010. *Acta Juridica* 337 at 342.

¹¹ *Ibid.*

Section 83(4) states:

‘at any time after a company has been dissolved—(a) the liquidator of the company, or other person with an interest in the company, may apply to a court for an order declaring the dissolution to have been void, or any other order that is just and equitable in the circumstances; and (b) if the court declares the dissolution to have been void, any proceedings may be taken against the company as might have been taken if the company had not been dissolved’.

This clearly allows disgruntled creditors to try and get some sort of money back from the company or persons within it. This forms a protective shield for creditors and is a welcomed provision. Companies will not get be clear of debt just by merging with another entity and dissolving the targets company.

The second consequence is that ‘those of the merging companies which are not chosen to survive the merger are automatically dissolved upon implementation of the merger (also by operation of law)’.¹² This means that there is no need to formally liquidate the companies involved. Any person with an interest in the company may apply to have the dissolution of the company declared void. ‘If this remedy were to be used in the context of a merger (and there does not appear to be any legitimate reason why it could not), it is not clear whether this has the effect of resuscitating the dissolved company or merely has the effect of creating the basis of a claim against the merged company’.¹³ A person who has a claim against a dissolved merged entity will automatically have recourse against the newly formed merged entity. It would have been much easier to read and identify a merger or amalgamation if the definitions were split up.

1.2) Distinction Between a Merger and an Amalgamation with Reference to foreign Jurisdictions

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.¹⁴

¹² Section 83(1) read with s 116(5)(b); and Davids, Norwitz & Yuill op cit note 10 at 343.

¹³ Davids, Norwitz & Yuill op cit note 10 at 343.

¹⁴ Ronald J Gilson. *The Law and Finance of Corporate Acquisitions*. University Casebook Series. 1986. Pg 505.

The term merger is based on the idea of two becoming one, whilst an acquisition is a deal between two distinct parties, namely the acquirer and the target, and as such the transferring of shares or assets are transferred to the acquirer.¹⁵ The acquirer may buy the targets assets and acquire control or purchase some or all of the assets of the target.¹⁶ So once the assets are transferred, the acquirer assumes all liabilities of the target. 'To the extent that an acquirer is to assume any liabilities of the target, this would have to be done by way of appropriate contractual arrangements and would, in the absence of a court-sanctioned compromise, require the consent of all the creditors concerned'.¹⁷ This will be discussed further on into the paper. The key aspect in this process is that the entities remain separate and distinct, even though there has been a transfer of ownership of shares or assets from one entity to another and usually with a 'purchase price going to the seller in consideration for the assets disposed of'.¹⁸ Cassim describes a statutory merger as 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'.¹⁹ Rather than approaching a court, dissenting shareholders have the right not to enter the agreement by withdrawing their 'fair value'²⁰ of their shares in cash.²¹ This achieved by exercising their appraisal rights.

This new statutory merger represents two sides of a coin. The one side being the restructuring of businesses with the interest of economic growth being the

¹⁵ Deneys Reitz, Inc. 'South Africa: Amalgamations-A New Concept' available at http://www.deneysreitz.co.za/index.php/tools/print/south_africa_amalgamations_a_new_concept/new_s, accessed on 9 April 2010.

¹⁶ Ibid.

¹⁷ Ibid.

¹⁸ Ibid.

¹⁹ Maleka Femida Cassim. 'The Introduction of the Statutory Merger in South African Corporate Law: Majority Rule Offset by the Appraisal Right (Part 1)'. (2008) 20 SA Merc LJ 1–32 at 1

²⁰ In the California Corporation Code section '4300 provides that a shareholder dissenting from the approval of a merger or consolidation may, by complying with specified procedures,³ require the corporation to purchase his shares at their fair market value. If the corporation's offered price is refused by the shareholder, a purchase price shall be determined either by the court or by appraisers appointed by the court, whose determinations are subject to review by it.⁴ The statute gives no further definition of this compensation than is implicit in the term itself; the method of calculating "fair market value" is thus left for judicial determination'. Harry L. Fledderman. 'Corporations: Shareholders: Appraisal Rights: Compensation to Shareholders Dissenting from Mergers and Consolidations'. *California Law Review*. Vol. 40, No. 1 (Mar., 1952), pp. 140-147 at 140.

²¹ Ibid. and sec 164 of the new Companies act

standpoint. On the other, the interests of shareholders holding their investments in a company as well as the added protection of minority shareholders from majority discrimination.²² These are similar trends adopted from American, Canadian and New Zealand jurisprudence.²³

Dickinson stated that ‘the 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’.²⁴ An amalgamation contemplates the formation of one or more new companies which hold all of the assets and a liability previously held by the several amalgamating companies, whereas a merger does not require the formation of newly incorporated companies but contemplates a merger between existing companies.²⁵ There could be a vast amount of reasons why a company would choose to amalgamate. Such reasons include ‘the expansion of the business or operations of the company; to carry on the business of the company more economically or more efficiently; to attain economic, business and other goals of the company in efficient manner; to eliminate competition between the companies; to use economic, financial, technical and other sources efficiently and a company having vulnerable financial/economic position may prefer an amalgamation with another company so as to secure itself’.²⁶ Reasons will depend on the company’s goals.

It is worth considering the differing and confusing terminology used in other jurisdictions. In Canada the term ‘merger’ is used to ‘describe every form of business combination while the term ‘amalgamation’ is used in Canadian law for the procedure equivalent to a ‘merger’ under the new Act’.²⁷ A ‘merger’ in Delaware is the same to that of a ‘merger’ in the new Act, but an ‘amalgamation’, in terms of the

²²Ibid.

²³Ibid.

²⁴Dickinson J in *R v Black & Decker Manufacturing Co* [1975] 1 SCR 411 (SCC) at 422.

²⁵Deneys Reitz, Inc. ‘South Africa: Amalgamations-A New Concept’ available at http://www.deneysreitz.co.za/index.php/tools/print/south_africa_amalgamations_a_new_concept/new_s, accessed on 9 April 2010.

²⁶Somabruta Dutta. ‘Amalgamation’. *The Chartered Accountant*. December, 2001. Pg 1-7 at 2

²⁷FH Buckley, Mark Gillen & Robert Yalden *Corporations Principles and Policies* 3 ed. (1995) at 991 and s 181 of the Canada Business Corporations Act, 1985 (RSC 1985 c C-44)

new Act, is a 'consolidation' in Delaware.²⁸ In terms of the New Zealand Companies Act 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 new Act'.²⁹

In practice, a company will have the choice between the two structures. It will be based on a number of factors such as, which include, but not limited to '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'.³⁰

1.3) Policy Issues during the legislative process of the new Act

The new approach of allowing 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'.³¹ This represents a liberalisation of policy by the legislatures, a clear intention from the start of the legislative process.

The Standing Committee on Company and Law Reform recommended that a court-free procedure for amalgamation of a group of companies be introduced in the act. This included following the Singaporean model for the procedure of 'short form amalgamation'³², except 'that the board of directors of each amalgamating company

²⁸ Section 251(a) of the Delaware General Corporation Law, 2001 and Cassim op cit note 19 at 3.

²⁹ Section 219 of the New Zealand Companies Act 105 of 1993 and Cassim op cit note 19 at 3.

³⁰ Cassim op cit note 5 at 42.

³¹ Cassim op cit note 19 at 20.

³² 'Standing Committee on Company Law Reform- The Twenty-Fifth Annual Report 2008/2009' available at http://www.fstb.gov.hk/fstb/co_rewrite/eng/pub-press/doc/SCCLR_ar_08-09-e.pdf,

should make a solvency statement in relation to the amalgamating company in addition to the one in relation to the amalgamated company. The committee also suggested that when amalgamations involving insolvent companies or companies not of the same group, the requirement for court sanction should remain. This is a protective measure not only for creditors but for existing employees who may face termination if their employment if the amalgamation is to succeed. The SCCLR also agreed that the form of solvency statements used in the court-free amalgamation procedure should be applicable to other parts of the Bill.³³

Two opposing values are at issue. On the one side, companies need some form of flexibility so as to restructure their business in order to adapt to the changing business conditions and to further the economic growth of the company.³⁴ Whilst on the other side, but equally important, is the 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'.³⁵ The balance has been clearly shifted between these values as a result of the introduction of the statutory merger. Shareholders are now provided with more remedies and are given a substantial say with regard to a merging of a company.

accessed on 7 September 2010. There are two forms of court-free amalgamation procedures available under the Singapore Companies Act and the New Zealand Companies Act. They are the "short form amalgamation" procedure applies to intra-group amalgamation i.e. amalgamation of a holding company with one or more of its wholly-owned subsidiaries, or an amalgamation of two or more wholly-owned subsidiaries of the same holding company. The "long form amalgamation" procedure applies to merger of other companies."

³³ Ibid. Subsequently, the SCCLR endorsed the following requirements to be adopted in the solvency statements :-

'(a) as regards the amalgamating company's situation at the date of the solvency statement, there is no ground on which the amalgamating company could then be found to be unable to pay its debts; and
(b) the amalgamated company will be able to pay its debts as they fall due during the period of 12 months immediately after the date on which the amalgamation is to become effective. In forming their opinion, the directors shall take into account the 'contingent and prospective liabilities' of the amalgamated company'. It is worthy to note that the solvency and liquidity test now includes the above requirements and has to be presented to those companies and persons involved in the merger or amalgamation.

³⁴ Cassim op cit note 19 at 20.

³⁵ Ibid.

The new Companies Act is less conservative than its predecessor.³⁶ Nicholls states that 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'.³⁷ Shares, under the current regime will be more easily expropriated as a result of the cash consideration in a merger.³⁸ Shares are recognized in our law as propriety rights as well as in other common law jurisdictions.³⁹ This was emphasised in the Australian case of *Gambotto v WCP Ltd*⁴⁰ (with regard to the minority shareholders under the expropriation of shares) where the majority judgement stated that 'a share confers proprietary rights on the holder and is more than just a capitalised dividend stream'. In *Nicron Resources Ltd v Catto*⁴¹, the court described 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'.

The traditional view of the shareholder's right to retain his shares has been greatly improved by the introduction of the statutory merger provisions. This is a clear move from the current South African assertions, particularly, as Cassim describes 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.⁴²

³⁶ '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'. Cassim op cit note 19 at 20.

³⁷ 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>, accessed on 7 December 2010.

³⁸ Neil Finkelstein. 'Expropriation of Minority Interests and the Appraisal Remedy'. (1985) 27 *Business Law Reports (Articles)* at 234 available at <http://www.international.westlaw.com> accessed on 7 December 2010.

³⁹ Cassim op cit note 19 at 20.

⁴⁰ (1995) 182 CLR 432; 16 ACSR 1 (HC, Aus).

⁴¹ (1992) 8 ACSR 219 (**, NSW)

⁴² Cassim op cit note 19 at 21.

This meant that a shareholder had the right to remain the shareholder of the company, but in terms of the new statutory merger provisions, a shareholder cannot. The statutory merger diverges from the current view that 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’.⁴³

In *Neonex International Ltd v Kolasa*⁴⁴ the court saw a ‘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’. Appraisal rights, in terms of the new merger regime, will be used as a form of protection for shareholders from the expropriation of their shares. An in depth analyses will take place in Chapter 7.

This policy shift favours the adoption of appraisal rights and can be seen as a ‘substitution of liability rules for the previous property rules’.⁴⁵ The policy abandoned the idea that shareholders possess *vested rights* in their investment, and rather it follows the new approach that ‘shareholder interests are held subject to the exercise of collective shareholder judgment’.⁴⁶ This policy shift is similar to an ‘American-type approach’ to mergers and as such sees South Africa departing from the traditional English Law approach, along with Canada and New Zealand, however neither English nor Australian Law have adopted a statutory merger procedure that excludes the requirement of court approval and is similar to the approach in the current South African Companies Act.⁴⁷ Is this a blatant approach to this or was it overlooked. From the sections in the new Act, it can be seen that it was a clear departure from the courts having to give approval. It therefore eliminates on of the steps and is time and cost effective.

⁴³ Blackman, MS. Commentary on the Companies Act. *LAWSA* vol 3 (2006) at 15A-27.

⁴⁴ [1978] 2 WWR 593, 3 BLR 1 (SC, BC).

⁴⁵ Cassim op cit note 19 at 22.

⁴⁶ William T Allen & Reinier Kraakman. *Commentaries and Cases on the Law of Business Organizations*. Wolters Kluwer Law & Business. (2003) at 427-9(452)

⁴⁷ Cassim op cit note 19 at 22.

The aim of the Bill, now the Act, by the introduction of the statutory merger procedure aims to be a more effective mechanism for facilitating business combinations and fundamental transactions.⁴⁸ Cassim states that the 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’.⁴⁹

The other aspect the policy worked on was to achieve a balance between ‘minority oppression by the majority and minority dictation’.⁵⁰ As will be discussed further on, the new Act is weighted in favour of the majority and minorities are not given enough protection from oppression by the majority, but protection has significantly increased. The drafters of the new Act saw it fit not to discard the scheme of arrangement procedure as a means of effecting a business transaction, but rather made provisions for both a statutory merger and a scheme of arrangement. This is inline with Canadian and New Zealand Law which allows for both procedures.⁵¹ In these jurisdictions, even if a statutory merger was appropriate to the circumstances, a company would rather rely on a court-approved arrangement to effect the transaction.⁵² Companies may prefer this method if the 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, 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’.⁵³

⁴⁸ ‘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’. See Cassim op cit note 19 at 22.

⁴⁹ Cassim op cit note 19 at 22.

⁵⁰ *Ibid.*

⁵¹ Cassim op cit note 19 at 22.

⁵² Cassim op cit note 19 at 24.

⁵³ Cassim op cit note 19 at 24.

1.4) Scope of Application of the new Act

Section 115(1) of the new Act clearly specifies that all profit companies may amalgamate or merge in accordance with the procedure in chapter 5. This procedure is therefore applicable to public, private, state-owned and personal liability companies. The procedure is a welcomed one with regard to all profit companies, as it is 'often minority shareholders with illiquid stakes in small private companies that may find most useful the appraisal rights remedy and the other procedural safeguards provided for in the merger procedure'.⁵⁴

What is concerning about this procedure is that it is only available to South African companies and there are no provisions dealing with cross-border mergers and amalgamations with foreign companies. When reading the definition of a 'profit company' with the definition of a 'company' in terms of section 1 of the new Act, it is clear that it is only applicable to companies registered under the old and new Act, excluding those registered as external companies. This can be seen as overly restrictive bearing in mind the present global marketplace, in that foreign companies are free to acquire businesses in South Africa by other means like through a purchase of assets, meaning that that company would have to register as an external company under the new Act.⁵⁵ It is clearly a deterrent factor for foreign companies. A foreign company may make use of a South African subsidiary to effect a merger (a triangle merger (set out in footnote 56) and it can be expected that this form of merger will become popular. A triangle merger consists of three companies, two of which are 'in a holding and subsidiary company relationship'.⁵⁶

⁵⁴ Cassim op cit note 19 at 7.

⁵⁵ Davids, Norwitz & Yuill op cit note 10 at 354.

⁵⁶ Cassim op cit note 19 at 27. Cassim analyses a triangle merger and states that: ...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 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

Dauids explains that the ‘disadvantage of being limited to a South African subsidiary, however (as opposed to participating in a parent-to-parent merger), is that South African creditors will not have recourse to the much bigger balance sheet of the foreign parent, and that is precisely why foreign acquirers will generally prefer not to use parent-to-parent mergers’.⁵⁷

The acquisition of a foreign company by a South African company by merger will be governed by the target company’s jurisdiction of incorporation and ‘South African acquirer seeking to acquire a Delaware corporation would, as it is now able to do, most likely form a Delaware subsidiary and merge that with the target company’.⁵⁸ A practical difficulty which needs to be considered is that of exchange controls, which in terms of South Africa’s system, places restrictions on South African residents to hold shares in non-resident companies.⁵⁹ The current exchange control rules allow South African residents to hold foreign shares in the following circumstances: ‘a) if they are using their foreign investment allowance; (b) if the foreign company has an inward listing on the JSE; and (c) the shares are acquired as acquisition consideration shares and disposed of within 12 months after the acquisition’.⁶⁰ The exchange control restrictions are being relaxed and will not likely continue. Another possible concern is the potential prejudice of South African creditors to claim against an offshore entity when a South African business is merged into an offshore entity. This can be resolved by the use of a ‘reverse triangle merger’ where the South African target company survives the merger as a ‘wholly owned subsidiary of the acquirer’.⁶¹

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.

⁵⁷ Davids, Norwitz & Yuill op cit note 10 at 354.

⁵⁸ Davids, Norwitz & Yuill op cit note 10 at footnote 55.

⁵⁹ ‘Exchange control Rules’ available at

<http://www.reservebank.co.za/internet/publication.nsf/0/8b1c8768741bf40c42256c44003331a6?OpenDocument>, accessed on 17 November 2010.

⁶⁰ Ibid.

⁶¹ Davids, Norwitz & Yuill op cit note 10 at 354. A reverse triangle merger is similar to that of a triangle merger in that the:

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

If the South African company does not survive the merger, the foreign merged entity would be in all its entirety be considered to be conducting business in South Africa and would then have to register as a an external company and at the same time, it will allow creditors to bring claims against the company in South Africa.⁶² Other jurisdictions like the United States and Europe provide for cross-border mergers. In Europe they have the Cross-Border Mergers Directive 2005/56/EC for the cross-border mergers of limited liability companies. The United States has a framework in place to limit the ‘extraterritorial application of US securities regulations to offshore transactions that include US shareholders’.⁶³

There could be difficulties regarding the way in which the laws of the different jurisdictions are reconciled. Given the fact that other jurisdictions have provided for cross-border mergers it would suggest that these problems are not impossible to solve and the fact that there are many potential benefits for the South African economy. Similar results can be achieved using different methods and it would be worth considering an amendment to the Act to allow for such mergers.

Company H; secondly, that Company S, which is a newly formed company for the purposes of the merger, disappears under and pursuant to the merger; and thirdly that the former shareholders in Company T or the surviving company give up their shares in return for the merger consideration, usually in cash or shares in Company H. This is a rather illusory and artificial procedure, not least because the merger consideration is, in effect, paid to the shareholders of the *surviving* company, Company T, and not, as in the usual course, to the shareholders of the disappearing company in consideration for their shares in the disappearing company. See Maleka Femida Cassim. ‘The Introduction of the Statutory Merger in South African Corporate Law: Majority Rule Offset by the Appraisal Right (Part 2)’. (2008) 20 *SA Merc LJ* 147–176 at 147.

⁶² Section 23 of the new Act

⁶³ ‘US Securities and Exchange Commission Release 34–58597’ available at <http://www.sec.gov/rules/final/finalarchive/finalarchive2008.shtml>, accessed on 17 November 2010.

CHAPTER 2-

Background to the provisions in chapter 5 of the new Companies Act in relation to mergers and amalgamations and an analysis of the other provisions within the chapter.

2.1) Background to the provisions in chapter 5 of the new Companies Act in relation to mergers and amalgamations

It is vastly clear that Mergers and Acquisitions transactions amongst important companies will often have broad societal impact which will inevitably involve matters of both public interest and policy.⁶⁴ M&A activities almost, without fail, involve a significant amount of risk-taking, especially in the case of public companies, where these risky decisions are often made and taken in the first instance not by the owners of the businesses involved, but rather by the shareholders of the participating companies and also by directors acting as fiduciaries for the shareholders' benefit.⁶⁵ With the reasons mentioned above, M&A activity needs proper regulation and is critically important that regulation should seek to strike a balance between 'encouraging economic activity and prudent risk-taking while appropriately protecting the interests of the many stakeholders in the companies involved, the economy and society at large'.⁶⁶ The procedure should be as simple as possible to avoid any sorts of confusion. M&A activity has therefore a fundamental part of the South African Economy. This was clearly noted by the drafters of the New Companies Act. The Bill declared as one of its purposes, is 'to provide for equitable and efficient amalgamations, mergers and takeovers of companies', yet closer inspection of section 7, the purpose provision of the new Act shows that this is not one of its purposes⁶⁷, an untimely oversight by the drafters. Chapter 5 of the New Act contains provisions devoted to Fundamental Transactions, Takeovers and Offers.

⁶⁴ Davids, Norwitz & Yuill op cit note 10 at 338.

⁶⁵ Ibid.

⁶⁶ Ibid.

⁶⁷ Ibid.

The Department of Trade and Industry (DTI) whilst preparing the new Act, decided to acquire the assistance of practitioners and academics from foreign jurisdictions as well as South Africa with the purpose being to have a comparative analysis, with that of other jurisdictions. This included hearing issues regarding how companies are governed and how M&A, are handled in other jurisdictions (including the United States, United Kingdom, Australia, New Zealand, Canada and many lesser others) before deciding on what model to incorporate and develop to fit the needs of the South African economic and policy driven environment.⁶⁸ The effect of such contributions is that the pre-existing law, being of English decent, has now added improvements and innovations gathered from other jurisdictions, which include the addition of the statutory merger procedure, an appraisal remedy and the a requirement of disclosing a significant acquisition of a public company's shares.⁶⁹ The aim of these improvements was and is to ensure that these are more than just procedures, but rather protective measures and as such keeping inline with the theme of promoting public interest whilst challenging common assumptions and existing corporate formalities with regard to the public.⁷⁰

As will be seen with the example below with regard to hostile takeovers, the legislators were not ready to part with certain formalities present in other countries. This can be seen as both negative and positive, but clearly shows policy preferences and a consideration and examination of the South African economic sphere.⁷¹ In the United States, the board of directors of a target company are given a significant amount of leeway in responding to a hostile takeover bid, which include 'adopting reasonable defensive measures if the directors consider that appropriate to protect the shareholders'.⁷² One can therefore say that American Law is more board orientated, whilst the South African corporate governance regime is shareholder orientated, which the legislators clearly took into account. As an example of this, the board is prohibited under s 126 of the new Act from taking any action to impede a takeover bid. This is consistent with the current anti-frustration provisions in Rule 19 of the

⁶⁸ Davids, Norwitz & Yuill op cit note 10 at 338.

⁶⁹ Ibid.

⁷⁰ Davids, Norwitz & Yuill op cit note 10 at 339.

⁷¹ Ibid.

⁷² Davids, Norwitz & Yuill op cit note 10 at 340.

Securities Regulation Panel Code on Takeovers and Mergers and the Rules of the Securities Regulation Panel (the Code). A fundamental concept still retained in the Act, is that of the notion that directors still represent the shareholders and as such serve their will and can be removed by the shareholders at any time by an ordinary resolution.⁷³ This provision, inline with English law, allows for South African companies to be more vulnerable to takeover bids than American companies. Section 123 of the new Act still maintains the mandatory offer requirement for a buyer crossing the particular threshold.⁷⁴ It was shown by the South African and English lawyers, whilst drafting, that the US does not have such a concept (that of minority shareholder protection), and that the US lawyers had a problem understanding why a class of transactions, ie minority investments, should as *a priori* rule, be so restrictive.⁷⁵

2.2) An analysis of other provisions in chapter 5

The three procedures used in South Africa to implement an M&A transaction which involve the acquisition of entire companies are: the sale of a business as a going concern; the tender offer and the scheme of arrangement. They are all set out in chapter 5 of the new Act. This section of the chapter will not analyse each procedure but will rather give a brief outline of each and provide factors as to why you would consider one procedure to another and if there are any changes from that of the previous Companies Act.

2.2.1) Sale of a Business as a Going Concern- Section 112

In terms of section 112(2) of the new Act a company ‘may not dispose of all or the greater part of its assets or undertaking unless— (a) the disposal has been approved by a special resolution of the shareholders, in accordance with section 115; and (b)

⁷³ Section 65 of the New Companies Act

⁷⁴Section 123. The new Act prescribes that such specified threshold is to be promulgated by regulation by the Minister, but will not be greater than the 35 per cent currently provided for in the Code. There is therefore the possibility that it may be less than the current threshold as provided for in the Code.

⁷⁵ Davids, Norwitz & Yuill op cit note 10 at 340.

the company has satisfied all other requirements set out in section 115, to the extent those requirements are applicable to such a disposal by that company'. The shareholder and quorum approval requirements in this procedure are exactly the same for those of a merger, a court review process and the appraisal rights procedure. In terms of section 34 of the Insolvency Act⁷⁶, creditors must be given constructive notice of the transaction. A sale of business is not the preferred method used for the implementation of an M&A transaction involving the acquisition of a business or a company because of the 'costs, legal formalities and time that is normally involved for transferring of a business from one entity to another'.⁷⁷

The merger procedure has a distinct advantage in that over a straight sale of business it provides for the 'automatic assumption by the merged entity of the property and obligations of the merging entities, as well the dissolution by operation of law of the non-surviving entities without needing to go through formal liquidation proceedings'.⁷⁸ However the sale of business or its assets may be useful when an acquirer wants to pick certain assets and/or obligations of the target company instead of acquiring all of them, like in a merger.⁷⁹ Davids recommends that the parties 'would still need to be careful that the conveyance of the chosen assets does not operate as a fraud on the creditors of the seller by leaving it with insufficient assets to satisfy its liabilities'.⁸⁰ Although the formalities involved in a disposal in section 112 is similar to a merger procedure, it must be kept in mind that only the shareholders of the disposing company would have to approve the transaction and this is very useful in situations where the acquirer's shareholders approval cannot be obtained.⁸¹

2.2.2) A Scheme of Arrangement-Section 114

A scheme of arrangement procedure allows for great flexibility. The procedure involves an:

⁷⁶ Insolvency Act 24 of 1936

⁷⁷ Davids, Norwitz & Yuill op cit note 10 at 368.

⁷⁸ See definition above; section 115 of the new Act and Davids, Norwitz & Yuill op cit note 10 at 368.

⁷⁹ Ibid.

⁸⁰ Davids, Norwitz & Yuill op cit note 10 at 368.

⁸¹ Section 112 of the new Act

arrangement between the company and holders of any class of its securities, including a reorganisation of the share capital of the company by way of, among other things— (a) a consolidation of securities of different classes; (b) a division of securities into different classes; (c) an expropriation of securities from the holders; (d) exchanging any of its securities for other securities; (e) a re-acquisition by the company of its securities; or (f) a combination of the methods contemplated in this subsection⁸²

This has been used for implementing a ‘friendly takeover’ within the South African context and normally, a scheme of arrangement is entered into between the ‘acquirer, the target and the target shareholders, whereby the acquirer will acquire all or a substantial portion of the target’s shares’.⁸³ This allows an ‘acquirer who wants 100 per cent control to squeeze out the minority with a lower shareholder approval threshold (75 per cent) than a tender offer (90 per cent)’.⁸⁴ It means that it will only allow the acquirer to acquire the target as a subsidiary. Cassim stated, on the Bill, 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’⁸⁵ and further added that the New Zealand approach could be used as a template as 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’.⁸⁶ Discretion is given to the courts as to who may be heard in an application for the approval of the arrangement. The court will then grant an appropriate order for the dissenting shareholders.

The disadvantage of this procedure had been that it required judicial sanction of the scheme and this made it time consuming and costly. However under the new Act, this is no more required, instead the company must provide an ‘independent expert report’ for the board and its shareholders on the transaction, which the shareholders must then approve by special resolution, like in the manner of a merger⁸⁷.

⁸² Section 114(1) of the new Act

⁸³ Davids, Norwitz & Yuill op cit note 10 at 369.

⁸⁴ Ibid.

⁸⁵ Cassim op cit note 19 at 24

⁸⁶ Ibid.

⁸⁷ Sections 114(2) and 114(3) of the new Act. The report must at minimum

Dissatisfied shareholders are also allowed to apply in limited circumstances for a court review of the process and may exercise their appraisal rights, similar to that of a merger procedure⁸⁸. This new procedure is a fairly straight forward even though an independent expert report is required. The formalities are much less than that of a merger procedure as no creditor notification is needed and only the target shareholders approval is needed. The questions that needs to be asked is whether South African practitioners will continue to use this procedure for the implementation of M&A's, bearing in mind that they are familiar with it and the previous major drawback being the involvement of the court is no longer required⁸⁹. The scheme of arrangement procedure will most likely continue, although it is not as versatile as the merger procedure provided for in the new Act. Davids explains that 'the greater range of transactions possible under the merger procedure is likely to make the merger procedure a more useful tool in many circumstances'⁹⁰. It will be interesting to view over the coming months, when the new Act is implemented, how a scheme of arrangement and the merger procedure will coexist as forms of M&A transactions and whether one of them will dominate the arena⁹¹, but as it stands, many will choose the scheme of arrangement method as this is what they are familiar with. Rather be safe and cost effective than cost the company more at a later stage, which also includes subjecting a company to a procedure unknown to them. This can result in further details in implementing a merger.

'(a) state all prescribed information relevant to the value of the securities affected by the proposed arrangement;(b) identify every type and class of holders of the company's securities affected by the proposed arrangement; (c) describe the material effects that the proposed arrangement will have on the rights and interests of the persons mentioned in paragraph (b); (d) evaluate any material adverse effects of the proposed arrangement against— (i) the compensation that any of those persons will receive in terms of that arrangement; and (ii) any reasonably probable beneficial and significant effect of that arrangement on the business and prospects of the company; (e) state any material interest of any director of the company or trustee for security holders, and state the effect of the arrangement on those interests and persons; (f) state the effect of the proposed arrangement on the interest and person contemplated in paragraph (e); and (g) include a copy of sections 115 and 164.'

⁸⁸ Section 115 and 164 of the new Act

⁸⁹ Davids, Norwitz & Yuill op cit note 10 at 369.

⁹⁰ Davids, Norwitz & Yuill op cit note 10 at 369.

⁹¹ Ibid.

2.2.3) Tender Offer-Section 124

The tender offer procedure in the new Act is similar to the one currently used in South Africa. In terms of section 124, 'acquirers are required to make a mandatory offer for all the shares of the target once they have acquired a specified percentage of the target's shares (still to be determined by regulation, but which may not be more than the current threshold of 35 per cent), an acquirer can squeeze out the minority if 90 per cent or more of the shareholders not related to the acquirer accept its offer and the directors are not entitled, as in the UK, to take any actions that may frustrate the bid'.⁹² The tender offer was used as a takeover procedure because it was a fast procedure as no recourse to the courts was needed, but the downside was 'at least for the acquirer who was looking to squeeze out the minority, was that a much higher threshold of shareholder acceptances (90 per cent) was required than under a scheme (75 per cent)'.⁹³ Mergers and a scheme of arrangement just require 75 per cent majority approval and thus is an easier option to squeeze out the minority, especially with regard to a scheme of arrangement as no court approval is required. A tender offer does not need the approval of the acquirer's shareholders, unlike a merger, nor does it confer any appraisal rights on the part of the acquirer or targets' shareholders.⁹⁴ All these factors will be taken into account when choosing a procedure for the given situation. A clear disadvantage of both a scheme of arrangement and a merger is that both require co-operation of the targets' board and are therefore only appropriate for a friendly offer, whilst a tender offer will be the most suited for an acquiring company in the context of a hostile takeover⁹⁵. South Africa has not really shown interest in hostile takeovers as can be seen in the recent failed attempts by Nedbank Limited of Standard Bank of Southern Africa and that of Gold Fields by Harmony Gold.⁹⁶

⁹² Section 124 of the new Act and Davids, Norwitz & Yuill op cit note 10 at 369.

⁹³ Davids, Norwitz & Yuill op cit note 10 at 370.

⁹⁴ Davids, Norwitz & Yuill op cit note 10 at 370 and 'in a triangular merger where the merging party is not the acquirer itself but its subsidiary, the vote of the acquirer's shareholders may not be required, unless the acquirer is a listed company and the transaction is one which is classified as a category 1 transaction under section 9 of the JSE Listing Requirements'.

⁹⁵ Davids, Norwitz & Yuill op cit note 10 at 370.

⁹⁶ Ibid.

There are a number of considerations which play apart in choosing the adequate procedure for the implementation of an M&A transaction. The merger procedure discussed above provides for great flexibility and versatility and will be the one most used by in practice as practitioners as they become familiar with the law and its possibilities. It is my view that in the next few months until the new Act is implemented, a scheme of arrangement will take precedent. Companies will want to avoid any uncertainty. A result of these provisions being enacted into our law is that there could be a flood of merger activity before the new Act comes into force. This may result in the Competition Commission not being able to handle the work load placed on them and as a result many aspects of the procedure could in fact be overlooked. This is clearly not the way mergers should be conducted, but practitioners should keep in mind that companies will want the most inexpensive and quickest method to merge. Although the courts will be required to be apart of the procedure, companies will in most circumstances be happier. The use of the courts provides stability and a sense of calmness.

CHAPTER 3-

Mergers and Acquisition provisions within the new Act and a discussion of a Statutory Merger

3.1) Merger and Acquisition provisions in the new Act

Chapter 5 deals with Mergers and Acquisitions under the heading of Fundamental, Transactions, Takeovers and Offers. Many of the old ways of implementing business combinations are still retained like that of a scheme of arrangement, the tender offer and sale of a business going concern. A review of the chapter will show that there are changes to the current procedures, but also at the same time, this regime has been supplemented by the introduction of two new concepts into our company law. These include a statutory merger procedure, and an appraisal rights remedy for dissenting shareholders. As stated above, South Africa has usually not provided for mergers in the direct meaning of the word, 'where two or more corporate entities merge or amalgamate into a single entity'.⁹⁷ As stated above, business combinations have normally been implemented through the acquisition by one company of the shares of another, using one of these methods: a scheme of arrangement, the tender offer and sale of a business going concern.

Cilliers states that, in the South African context, the use of the term 'merger' or 'amalgamation' has in history, been used to refer to such transactions whereby:

a company acquires control of the assets of the other 'merging' company (or companies) either through acquiring the shares in that company (or companies), or through acquiring the assets and assuming the liabilities of that company (or companies), with the shareholders in the other merging company (or companies) becoming shareholders in the acquirer and, in the latter case, the other merging company (or companies) being dissolved⁹⁸

A study of the South African Companies Act 61 of 1973 reveals to us section 313, which makes reference to an 'amalgamation'. This term is used very loosely with no

⁹⁷ Davids, Norwitz & Yuill op cit note 10 at 340.

⁹⁸ H.S. Cilliers and M Benade. *Cilliers and Benade Corporate Law 3rd Edition..* (2000) at 460-1

definition attached to it.⁹⁹ One of the preferred methods currently being used to implement M&A transactions is that of a court driven process within the context of a scheme of arrangement.¹⁰⁰ As will be shown later, the new provisions for the procedures mentioned above is aimed at avoiding court processes.

3.2) The Concept of a Statutory Merger

The statutory merger procedure originates from the United States and was codified in statutes in the 1820's.¹⁰¹ It is described as a 'simple, uncomplicated and effective procedure'¹⁰² South Africa did not have a true merger procedure.¹⁰³ The new Companies Act adopts, but not its entirety, the concept of a statutory merger procedure. It allows companies by agreement and with the necessary approval from the company's shareholders, to merge their liabilities and assets into a combined entity.¹⁰⁴ There is no need for court approval of the merger. The statutory merger procedure is thus an additional procedure and not a replacement of the existing methods for companies who want to effect business combinations and fundamental

⁹⁹ Section 313- Provisions facilitating reconstruction or amalgamation. '(1) If an application is made to the Court under section 311 for the sanctioning of a compromise or arrangement proposed between a company and any such persons as are referred to in that section, and it is shown to the Court that the compromise or arrangement has been proposed for the purposes of or in connection with a scheme for the reconstruction of any company or companies or the amalgamation of any two or more companies, and that under the scheme the whole or any part of the undertaking or the property of any company concerned in the scheme (in this section referred to as the 'transferor company') is to be transferred to another company (in this section referred to as the 'transferee company') the Court may, either by the order sanctioning the compromise or arrangement or by any subsequent order, make provision for all or any of the following matters: (a) The transfer to the transferee company of the whole or any part of the undertaking and of the property or liabilities of any transferor company; (b) the allotment or appropriation by the transferee company of any shares, debentures or other like interests in that company which under the compromise or arrangement are to be allotted or appropriated by that company to or for any person; (c) the continuation by or against the transferee company of any legal proceedings pending by or against any transferor company; (d) the dissolution, without winding up, of any transferor company; (e) the provision to be made for any persons who, within such time and in such manner as the Court may direct, dissent from the compromise or arrangement; (f) such incidental, consequential and supplemental matters as are necessary to secure that the reconstruction or amalgamation shall be fully and effectively carried out: Provided that no order for the dissolution, without winding up, of any transferor company shall be made under this subsection prior to the transfer in due form of all the property and liabilities of the said company...'

¹⁰⁰ Davids, Norwitz & Yuill op cit note 10 at 340 at footnote 2.

¹⁰¹ Natasha Bouwman . 'New road for M&As : Company Law'. Without Prejudice, Vol 9, Issue 5, June. 2009. Pg 33-35 at 33.

¹⁰² Cassim op cit note 19 at 26.

¹⁰³ Cassim op cit note 5 at 42.

¹⁰⁴ Davids, Norwitz & Yuill op cit note 10 at 341.

transactions and therefore provides another option for companies and businesses.¹⁰⁵ This procedure was developed so as to provide for the wide array of needs, reasons and circumstances for fundamental transactions and business combinations.¹⁰⁶ This is a clear departure from the old system and as such brings South Africa inline with the United States, France, Germany, New Zealand and Canada, all of which provide for some form of a court free statutory merger procedure.¹⁰⁷

The juridical nature and the effect of a statutory merger was described in *R v Black & Decker Manufacturing Co*:

[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.¹⁰⁸

The new Companies Act explicitly provides that a merger has no effect on the existing liability of any of the constituent companies to criminal prosecution (despite the disappearance or dissolution of the relevant constituent company), 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 company.¹⁰⁹ Parties to a transaction must consider this as there could be serious issues for the company surviving and its shareholders. Companies during the agreement process must disclose if they are part of any action. All valuable information needs to be disclosed and once the other company is made aware of this information, it then needs to be disclosed to the board and the shareholders. A copy of the agreement should be made available to everyone apart of the process. An electronic copy will suffice.

¹⁰⁵ Cassim op cit note 5 at 41.

¹⁰⁶ Cassim op cit note 5 at 42.

¹⁰⁷ Ibid.

¹⁰⁸ [1975] 1 SCR 411 (SCC) at 420-2.

¹⁰⁹ Cassim op cit note 5 at 42.

3.2.1.) The New Procedure

Within the definition, mentioned in chapter 1, it is clear that there are two wide categories of transactions which qualify as either a merger or amalgamation. The first being, section a, which in the draft was called a merger, 'where each of the merging companies is dissolved and the assets or liabilities of the merging companies are transferred to a newly formed company or companies'¹¹⁰ and secondly, section b, which in the draft was called an amalgamation, 'where at least one of the merging companies survives, and the assets or liabilities of the non-surviving merging companies, which are then consequently dissolved by operation of law, are transferred to the surviving company or companies and, if applicable, a newly formed company or companies'.¹¹¹ The distinction between an amalgamation and merger is widely used in American jurisprudence and was made in a previous draft of the new act, but in the final piece of legislation, the legislators opted to leave out such distinction which is regrettable, because it is unclear whether these terms are interchangeable or whether they in fact represent or reflect to distinct transactions.¹¹² The procedures for the implementation of these two types of structures are very similar.

Cassim notes that there is nothing noteworthy about this as both these transactions are subject to the same requirements under the act and that 'the terminology used to describe transactions of this nature differs greatly from jurisdiction to jurisdiction, and there is no generally accepted meaning of the terms 'merger' or amalgamation'.¹¹³ A clear objective achieved by the drafters by eliminating this distinction is that they have provided a great amount of flexibility as to the type of transaction they wish to use where the merged businesses will eventually stand and is fairly straightforward so as to be in line with the act's intention of facilitating business combinations.¹¹⁴ What is a key factor and of great importance is that there is only limited recourse to the judicial system, thus making sure that the procedure is

¹¹⁰ Section 1 of the New Companies act at (a).

¹¹¹ Section 1 of the New Companies act at (b).

¹¹² Davids, Norwitz & Yuill op cit note 10 at 342.

¹¹³ Cassim op cit note 19 at 3.

¹¹⁴ Davids, Norwitz & Yuill op cit note 10 at 342.

highly efficient and cost reasonable, as would normally be the case if one did approach the court. In comparison, a scheme of arrangement procedure requires court recourse and this is both time consuming and expensive¹¹⁵. As it seems, the courts now have very limited involvement in the merger procedure, which in turn heightens the potential prejudice to stakeholders and shareholders, but they are not left without any recourse. The new act provides for the appraisal rights remedy which dissenting shareholders have available to them in terms of section 164; also limited recourse like what shareholders and creditors have to courts and section 163 which provides relief from oppressive or prejudicial conduct or from abuse of separate juristic personality of company. These will be discussed further on in chapter 6.

3.2.2) The Stages of the New Merger Procedure

I will focus on the four main stages of the procedure being: the merger agreement; board of directors of all merging companies approve the merger based on the grounds that upon the implementation of the merger will satisfy the solvency and liquidity test; the shareholder approval process and the implementation of the merger. This four step procedure applies to widely held companies. The application of this procedure 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'.¹¹⁶

All other types of companies need only comply with the solvency and liquidity test in order for them to merge. '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'.¹¹⁷ In absence of an active trading market of shares 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

¹¹⁵ Ibid.

¹¹⁶ Section 1 of the new Act and Cassim op cit note 19 at 6

¹¹⁷ Cassim op cit note 19 at 7

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 the company'.¹¹⁸ As a direct result shareholders in closely held companies would be advised 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'.¹¹⁹ Only a merger agreement and board approval will be discussed in this chapter as Chapter 4 will provide an in depth look into the shareholder approval process as well the implementation of a merger.

3.2.2.1) The Merger Agreement

Section 113(2) of the new Act states that 'two or more companies proposing to amalgamate or merge must enter into a written agreement setting out the terms and means of effecting the amalgamation or merger'. This section contains a list of particular items and matters which need to be included in the agreement. They are:

(1) the proposed Memorandum of Incorporation of any new company to be formed by the amalgamation or merger; (2) the name and identity number of each proposed director of any proposed amalgamated or merged company; (3) the manner in which the securities of each amalgamating or merging company are to be converted into securities of any proposed amalgamated or merged company, or exchanged for other property; (4) if any securities of any of the amalgamating or merging companies are not to be converted into securities of any proposed amalgamated or merged company, the consideration that the holders of those securities are to receive in addition to or instead of securities of any proposed amalgamated or merged company; (5) the manner of payment of any consideration instead of the issue of fractional securities of an amalgamated or merged company or of any other juristic person the securities of which are to be received in the amalgamation or merger; (6) details of the proposed allocation of the assets and liabilities of the amalgamating or merging companies among the companies that will be formed or continue to exist when the amalgamation or merger agreement has been implemented; (7) details of any arrangement or strategy necessary to complete the amalgamation or merger, and to provide for the subsequent management and operation of the proposed amalgamated or merged company or companies; and (8) the estimated cost of the proposed amalgamation or merger.¹²⁰

Many of the above items are less important than others and many are not a requirement in all jurisdictions which use this merger form, mainly from the fact that

¹¹⁸ Ibid.

¹¹⁹ Cassim op cit note 19 at 8.

¹²⁰ Sections 113(2) (a) – (h)

many stringent requirements may increase the risk of challenges facing the transaction.¹²¹ The items are clearly set out and in my view this is not an exhaustive list. Many companies will want to add other items so as to provide the shareholders with every bit of available information. Agreements should be made to fit the profile of that company, and not a 'one agreement fits all' approach. Prescriptive matters must be concluded in the agreement and it is also clear that companies now have a broad system in which to structure their merger transaction in such a way that it meets its own requirements. The new Act 'contemplates not only a 'traditional' merger transaction, where shares in the merging companies are converted into shares in the merged entity, but also allows for other forms of consideration to be paid to the shareholders of the merging companies in addition to or in lieu of having their shares converted'.¹²² This now includes the possibility of shareholders of the entities merging, receiving shares in an entity other than the merged entity, like a holding company of the merged entity, as consideration.¹²³ Section 113(2)(e) states that 'the merger agreement should specify the manner of payment of any consideration other than the issue of shares in the merged entity or 'any other juristic person the securities of which are to be received in the amalgamation or merger'. This section is not clear enough, but it appears that 'the consideration contemplated could include shares in an entity other than the merged entity'.¹²⁴

This form of an agreement will in turn help the parties meet their objectives by structuring the transactions in a manner that best suits them. To illustrate this point, Davids, Norwitz & Yuill provide a fitting example where:

the buyer (B) could acquire the target (T) through a 'reverse triangular merger' in which B creates a merger subsidiary (S) that merges into T, with T surviving the merger as a wholly owned subsidiary of B, and T's shareholders receiving shares in B. Benefits of this structure include the ability to interpose a corporate veil to shield B from liabilities at T, and the ability, because T survives the merger, to avoid triggering approval rights in T's contracts and franchises.¹²⁵

¹²¹ Davids, Norwitz & Yuill op cit note 10 at 343.

¹²² Ibid.

¹²³ Ibid.

¹²⁴ Ibid.

¹²⁵ Ibid. and for these reasons, the reverse triangular merger is by far the most common structure used in M&A in the United States and has recently been approved for cross-border mergers in Japan.

Under the new laws, another type of structure can be or might be used which is called the 'top-hat' or 'double-dummy structure' which are renowned for transactions styled as 'mergers-of-equals'.¹²⁶ An example would be within a structure 'a new holding company (Newco) creates two merger subsidiaries, each of which merges into one of the two pre-existing merging companies, with the end result being that each of the merging companies survives as a wholly owned subsidiary of Newco, and all of the shares of both merging companies are converted into shares of Newco'.¹²⁷ Other examples of this 'top-hat' structure include mergers of *America Online, Inc* and *Time Warner Inc* to form *AOL Time Warner* and of *Phillips Petroleum Company* and *Conoco, Inc* to form *Conoco-Phillips*.¹²⁸ It is interesting to note that in the United States there are tax reasons in some cases to use this structure but it also has the effect of not having one company appear to acquire. This flexibility can be shown presently with the recent merger of pharmaceutical companies *Merck and Schering Plough*, which was engineered as a reverse merger, which entailed the smaller *Schering Plough* buying the much larger *Merck*, with the effect of it changing its name to *Merck* so as to avoid any contractual impediment.¹²⁹

There is also no limitation or preventative measures in place which prohibits payment of a cash consideration, but within the context of a merger, it presents some controversy in the sense that it can be used to expropriate or freeze-out minority shareholders, like in Norway and Netherlands, may place a restriction on the proportion of the consideration which is paid out in cash¹³⁰, but many other jurisdictions like the United States and Canada allow for considerations to be paid in cash.

Under the current Companies act, section 440K¹³¹, a squeeze-out is when minority shareholders are made to sell their shares to a third party acquirer and it is permissible within a tender offer, but only when the third party has acquired more

¹²⁶ Davids, Norwitz & Yuill op cit note 10 at 344.

¹²⁷ Ibid.

¹²⁸ Ibid.

¹²⁹ Ibid.

¹³⁰ Davids, Norwitz & Yuill op cit note 10 at 345.

¹³¹ Compulsory acquisition of securities of minority in affected transaction.

than 90 per cent of the issued shares.¹³² Mergers require a much lower shareholder approval threshold of 75 per cent. The concern around this is that a payment of a cash consideration to the minority shareholders of the target company may be used as a way in which to expropriate the minority shareholders without having to consider the higher threshold of acceptances needed for a squeeze-out.¹³³ Interesting to note is that 75 per cent is required for a scheme of arrangement which can be used as well, to squeeze out minority shareholders, although a scheme has to be sanctioned by a court so that there is adequate protection for shareholders. Under the new Act a scheme of arrangement has very limited court involvement as that of a merger.

Interestingly there is no provision in the new Act which suggests that a mix between shares and cash consideration is prohibited. Norwitz states that it would be possible 'for a buyer to offer a mix of cash and share consideration, which might be a fixed blend of x shares and y rand per target company share or could be structured to allow target shareholders to choose cash or shares with a mechanism to pro-rate the oversubscribed form of consideration'.¹³⁴ This is still inline with the intentions of the Act as it promotes flexibility so as to reflect the parties' desires and is a well added advantage of the new merger system for the implementation of M&A transactions.¹³⁵ This could be taxing on a company if the targets shareholders only want a cash consideration and even more burdensome if the company does not have that type of cash readily available. In terms of giving them shares, a company may be placed in a vulnerable position with regard to future payments and debts.

3.2.2.2) Board Approval

The new Companies Act 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',¹³⁶ unlike

¹³² Davids, Norwitz & Yuill op cit note 10 at 345.

¹³³ Ibid.

¹³⁴ Ibid.

¹³⁵ Ibid.

¹³⁶ Cassim op cit note 19 at 15. See section 251(b) of the Delaware General Corporation Law and section 221(1)(a) of the New Zealand Companies Act, 1993.

Delaware and New Zealand. An amalgamation or a merger may only take place, under the new Act, once the board each of the amalgamating or merging companies are satisfied that the ensuing amalgamated or merged company will satisfy the solvency and liquidity test.¹³⁷ The solvency and liquidity is set out in the new Companies Acts section 4.¹³⁸ This section clearly sets out that a company has to satisfy this test in order to proceed and states that it will only satisfy the test when the company is able to meet its liabilities as they fall due and that its assets must not exceed its liabilities. This is one of the protective measures introduced into the Act. The solvency and liquidity test has been incorporated into South African law with regards to company providing financial assistance in connection with the acquisition of its shares, section 38 of the old Act, or for share buy-backs, section 85 of the old Act, in order with the intentions to move away from a regime based on capital maintenance to a new statutory order.¹³⁹ A similar picture is portrayed in the United States under state laws¹⁴⁰ and under the new English Companies Act¹⁴¹ which allow for payment of distributions and dividends to shareholders.

¹³⁷ Deneys Reitz, Inc. 'South Africa: Amalgamations-A New Concept' available at http://www.deneysreitz.co.za/index.php/tools/print/south_africa_amalgamations_a_new_concept/new_s, accessed on 9 April 2010.

¹³⁸ 71 of 2008. Section 4 states:

4. (1) For any purpose of this Act, a company satisfies the solvency and liquidity test at a particular time if, considering all reasonably foreseeable financial circumstances of the company at that time— (a) the assets of the company or, if the company is a member of a group of companies, the aggregate assets of the company, as fairly valued, equal or exceed the liabilities of the company or, if the company is a member of a group of companies, the aggregate liabilities of the company, as fairly valued; and (b) it appears that the company will be able to pay its debts as they become due in the ordinary course of business for a period of— (i) 12 months after the date on which the test is considered; or (ii) in the case of a distribution contemplated in paragraph (a) of the definition of 'distribution' in section 1, 12 months following that distribution. (2) For the purposes contemplated in subsection (1)— (a) any financial information to be considered concerning the company must be based on— (i) accounting records that satisfy the requirements of section 28; and (ii) financial statements that satisfy the requirements of section 29; (b) subject to paragraph (c), the board or any other person applying the solvency and liquidity test to a company— (i) must consider a fair valuation of the company's assets and liabilities, including any reasonably foreseeable contingent assets and liabilities, irrespective of whether or not arising as a result of the proposed distribution, or otherwise; and (ii) may consider any other valuation of the company's assets and liabilities that is reasonable in the circumstances; and (c) unless the Memorandum of Incorporation of the company provides otherwise, a person applying the test in respect of a distribution contemplated in paragraph (a) of the definition of 'distribution' in section 1 is not to be regarded as a liability any amount that would be required, if the company were to be liquidated at the time of the distribution, to satisfy the preferential rights upon liquidation of shareholders whose preferential rights upon liquidation are superior to the preferential rights upon liquidation of those receiving the distribution.

¹³⁹ Davids, Norwitz & Yuill op cit note 10 at 346.

¹⁴⁰ Section 6.40 of the Model Business Corporations Act

¹⁴¹ ss 829–853.

The solvency and liquidity test has been introduced into the new Act as one of the requirements for approval by the board of a merger. Its main aim is to provide all known persons apart of the merger that the company will be solvent after the merger. The boards of the merging companies must have reasonable belief that each company to the merged proposal will satisfy the solvency and liquidity test which will then be presented at a shareholders meeting so as to consider the transaction and they are also required to hand a copy or a synopsis of the merger agreement so as to inform them of their rights under section 115 which lists the requirements for shareholder approval as well as reasons for one to approach a court.¹⁴² Section 164 which subsequently deals with the appraisal rights procedure under the new Act.

The use of the 'objective reasonableness' standard for a boards approval instead of the 'subjective good faith' standard may amplify the risk of challengers by creditors, but the policy's aim is to provide creditor protections and the courts will make adequate limits if such a scenario arises.¹⁴³ Directors when exercising their fiduciary duties must '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'.¹⁴⁴ This is relevant when 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'.¹⁴⁵ In terms of the common law, directors must not abuse their powers by using them for collateral purposes.¹⁴⁶ Common law duties to act in good faith and to avoid a conflict of interest are codified in the new Act under section 76. Duties of directors are now also set out in King III.

¹⁴² Davids, Norwitz & Yuill op cit note 10 at 346. and section 113(5) which states: '(5) Subject to subsection (6), a notice of a shareholders meeting contemplated in subsection (4)(b) must be delivered to each shareholder of each respective amalgamating or merging company, and must include or be accompanied by a copy or summary of— (a) the amalgamation or merger agreement; and (b) the provisions of sections 115 and 164 in a manner that satisfies prescribed standards.'

¹⁴³ Davids, Norwitz & Yuill op cit note 10 at 346.

¹⁴⁴ Cassim op cit note 19 at 15.

¹⁴⁵ Ibid.

¹⁴⁶ Ibid.

It is the directors of a company and not the shareholders who are involved in the negotiation of the merger agreement.

These directors must make sure that during the negotiations they maintain their honesty and act in the best interests of the company. Directors must be able to make informed decisions on the merits of the agreement. This applies to all directors including those not involved in the merger negotiation.¹⁴⁷ Section 76(3) of the new Act would apply to this situation. The section states that ‘...a director of a company, when acting in that capacity, must exercise the powers and perform the functions of director— (a) in good faith and for a proper purpose; (b) in the best interests of the company; and (c) with the degree of care, skill and diligence that may reasonably be expected of a person— (i) carrying out the same functions in relation to the company as those carried out by that director; and (ii) having the general knowledge, skill and experience of that director’. With reference to the above situation(duty of care), the Delaware Court of Chancery stated in *Sealy Mattress Co of NJ, Inc v Sealy, Inc*¹⁴⁸ that ‘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’. This is reasonable and it should also not be submitted to various stakeholders.

Directors’ fiduciary duties would mean that a recommendation or statement be given to all the shareholders involved regarding advisability and merits of the merger agreement.¹⁴⁹ Shareholders need sufficient, accurate information and advice on the implications and nature of the merger for themselves, firstly, then the company.¹⁵⁰ This will provide the necessary information needed by the shareholder to make a conscious decision regarding the merger as well as the company’s future financial and business prospects. Another piece of vital piece of information for shareholders would be on what material interests each director has in the proposed merger. ‘The fiduciary duties of directors would most probably apply to this situation and would

¹⁴⁷ Cassim op cit note 19 at 16.

¹⁴⁸ 532 A 2d 1324 (Del Ch, 1987).

¹⁴⁹ Blackman op cit note 52 at 15A 54-55.

¹⁵⁰ Cassim op cit note 19 at 17

cover the requirements of shareholder information and advice, as would the anticipated new Takeover Regulations'.¹⁵¹

Section 115 of the new Act sets out the shareholders approval requirements in the new Act, but also states that it applies to a merger procedure as well as any scheme or arrangement or disposal of assets or undertaking. A proposed transaction mentioned above 'must be approved — by a special resolution adopted by persons entitled to exercise voting rights on such a matter, at a meeting called for that purpose and at which sufficient persons are present to exercise, in aggregate, at least 25% of all of the voting rights that are entitled to be exercised on that matter...'¹⁵²

In terms of section 65(9) of the new Act, 75 per cent of shareholders present at that meeting would then need to approve the transaction, whilst under section 65, the threshold may be reduced as low as 60 per cent plus 1 vote and it is also stated that: A company's Memorandum of Incorporation may permit—'(a) a lower percentage of voting rights to approve any special resolution; or (b) one or more lower percentages of voting rights to approve special resolutions concerning one or more particular matters, respectively, provided that there must at all times be a margin of at least 10 percentage points between the requirements for approval of an ordinary resolution, and a special resolution, on any matter'.¹⁵³

Is the reducing of thresholds likely to happen in practice, in particularly listed companies? Shareholders in a listed company will not be in favour of reducing thresholds, as a situation can exist where the minority can be exploited by the large or controlling shareholders, and shareholders would therefore be less interested in investing in companies where these thresholds have been stipulated in the Memorandum of Incorporation or for voting in favour of amending the Memorandum.¹⁵⁴ Davids, Norwitz & Yuill state that:

¹⁵¹ Ibid.

¹⁵² Section 115(2)a of the new Act

¹⁵³ Section 65(10).

¹⁵⁴ Davids, Norwitz & Yuill op cit note 10 at 347.

...even if it is possible, given that retail shareholders are generally fairly disinterested regarding technical matters such as the amendment of the company's constitutional documents, it may not be worth their while for a significant shareholder to push such amendments through, given that it may possibly create an unintended embedded discount in the shares of the relevant company. Significant institutional investors may well also put some pressure on companies in this regard.¹⁵⁵

In the context of private companies, a controlling shareholder, if not provided for in the Memorandum of Incorporation, would need a 75 per cent majority to amend the Memorandum of Incorporation and therefore in hindsight there would be virtually no incentive for the shareholders in wanting to reduce the threshold.¹⁵⁶ Reducing of the threshold would be a step backward and many shareholders will not approve of this method. This has the effect of excluding many shareholders during the process of merging and will certainly result in court proceedings.

3.3.) The Boards Power to Amend or Terminate the Merger Agreement

This section will deal with the termination or amendment of a merger agreement after the approval of the agreement by the shareholders. It is also viewed as a protective measure for the company after the said agreement. This has immense practical significance. In the US, it is customary for merger agreements 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'.¹⁵⁷

These contractual terms are useful in circumstances where the merger loses its appeal. This may happen when '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

¹⁵⁵ Davids, Norwitz & Yuill op cit note 10 at 347 at Footnote 23.

¹⁵⁶ Ibid.

¹⁵⁷ Cassim op cit note 19 at 18.

against it'.¹⁵⁸ In Delaware and Canada, legislation empowers the boards of directors of the companies to place in the merger agreement, termination provisions and the directors 'may in specified circumstances abandon or terminate the merger at any time before the effective date, *regardless* of shareholder approval'.¹⁵⁹

The new South African Companies Act does not contain such a section. However section 113(2) states that 'two or more companies proposing to amalgamate or merge must enter into a written agreement setting out the terms and means of effecting the amalgamation or merger and, in particular, setting out...' I believe that the legislators by the use of the words 'in particular' have meant that it is not a closed list of terms to be set out in the agreement. Agreements are tailor-made according to each company. The companies could in fact add the provision mentioned above to the agreement and proposal. The new Act would provide more clarity if this provision, that 'would empower the directors to abandon a merger at any time before it is filed regardless of shareholder approval'¹⁶⁰, were added to it. There is no provision within the new Act stating that a company cannot add this to their agreement(s). It should be noted that the termination of a merger will not avoid the contractual consequences of the termination.¹⁶¹ It would be necessary, while the new Act is still being enacted, to include such clauses. The procedure is still fairly new to South Africa and as such companies will always want an opt-out action plan.

It is very important in practice that any amendments to the merger agreement are allowed after the agreement has been approved by shareholders, provided that the merger has not been implemented or has come into effect.¹⁶² Directors of the merging companies may want to amend the agreement after the process of negotiating and closing a merger has been completed, if it is in fact necessary to do so.¹⁶³ This type of situation exists when one of the companies to the merger has approved the merger agreement and the other company refuses to do so unless

¹⁵⁸ Ibid.

¹⁵⁹ Section 251(d) of the Delaware General Corporation Law, 2001 and section 183(6) of the Canada Business Corporations Act, 1985.

¹⁶⁰ Cassim op cit note 19 at 18.

¹⁶¹ Ibid.

¹⁶² Cassim op cit note 19 at 19.

¹⁶³ Ibid.

certain provisions of the merger agreement have been amended or new provisions are added.¹⁶⁴ Cassim concludes that ‘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’.¹⁶⁵

The new Act needs to clarify the position of amendments to the merger agreement. If not, it could result in practical difficulties. The new act should 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’.¹⁶⁶ The American Model Business Corporation Act section 11.02(e) and the Delaware General Corporation Law section 251(d) allows for 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’. If any amendments are made to the act, the allowance of such a clause should be clearly stated and may even go as far as saying what needs to be placed in such a clause. Reasons may also be provided as to why a company may terminate an agreement.

3.4) The Advantages and Disadvantages of the Procedure

The introduction of the statutory merger procedure has the advantage that it will provide a simple and efficient procedure so that costs and time are saved for the ‘acquiring company to obtain full ownership of the target company or disappearing company at once’.¹⁶⁷ All assets will therefore vest in the newly amalgamated or merged company by operation of law. The one major disadvantage is that the

¹⁶⁴ Ibid.

¹⁶⁵ Ibid.

¹⁶⁶ Ibid.

¹⁶⁷ Bouwman op cit note 101 at 34.

acquiring company would 'automatically be liable for all obligations and liabilities of the non-surviving company, including liabilities that are not liquidated, contingent or of which the acquiring company was unaware'.¹⁶⁸ The assets and liabilities will automatically vest in the surviving company by operation of law, which means that there is 'no need for compliance with any of the legal formalities associated with the transfer, such as delivery, cession, assignment, novation, or delegation'.¹⁶⁹ This is seen as one of the advantages of a statutory merger. It saves time and money during the implementation stage.

A disadvantage of an automatic transfer by operation of law is that the 'acquiring company is, conversely, also automatically liable for all the obligations and liabilities of the disappearing company'.¹⁷⁰ This also includes 'unliquidated and contingent liabilities and even liabilities of which the acquiring company was unaware'.¹⁷¹ A major disadvantage for companies is if the acquiring company was not made aware of all the targets liabilities before the implementation of the merger. Companies should seek to know all of the targets liabilities as difficult as it may be. Shareholder confidence will drop if it is presented later on that the company has acquired a substantial amount of debt that it was unaware of.

¹⁶⁸ Cassim op cit note 19 at 3.

¹⁶⁹ Cassim op cit note 5 at 41.

¹⁷⁰ Ibid.

¹⁷¹ Cassim op cit note 5 at 41.

CHAPTER 4-

Procedural Aspects of section 115 and 116 respectively

4.1) Analyses of Section 115- Required approval for transactions contemplated in Part

This section of the chapter will discuss the procedure for a merger and highlight the difficulties within this new section in the new Act. I will seek to establish a basic understanding of the provisions.

There are some worthy points regarding the quorum requirements as well as approval requirements. Firstly, as it appears, shareholders, like holders of preference shares, may be excluded if they have no voting rights in respect of a relevant transaction. Secondly, in terms of section 115(2)(b) of the new Act a proposed transaction must be approved 'by a special resolution, also adopted in the manner required by paragraph (a), by the shareholders of the company's holding company if any, if— (i) the holding company is a company or an external company; (ii) the proposed transaction concerns a disposal of all or the greater part of the assets or undertaking of the subsidiary; and (iii) having regard to the consolidated financial statements of the holding company, the disposal by the subsidiary substantially constitutes a disposal of all or the greater part of the assets or undertaking of the holding company'. In terms of section 115(4), voting rights are controlled 'by an acquiring party, a person related to an acquiring party, or a person acting in concert with either of them' will in turn be excluded from the calculation required for the quorum and approvals.¹⁷²

If a shareholder finds himself holding a 15 per cent or more of the voting rights against the proposed transaction, i.e. a merger, any dissenting shareholder may require the company to acquire court approval for the merger and in such a case the resolution cannot be implemented unless the requisite approval has been acquired.¹⁷³ Once again the procedure can be delayed. It can be costly for a company busy with a cross border merger, especially if time is of the essence. The company in these

¹⁷² Davids, Norwitz & Yuill op cit note 10 at 347.

¹⁷³ Section 115(3) of the new Act.

circumstances ‘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’.¹⁷⁴ This type of protection is distinct to South Africa, as it does not exist in jurisdictions that have merger statutes in place but is viewed as a policy matter, which is considered adequate protection in that given society were they are more reserved in bringing lawsuits to protect ones rights.¹⁷⁵

Whether or not the 15 per cent threshold is reached, any shareholder who has gone against the resolution, may apply to court, which ‘the court may grant leave only if it is satisfied that the applicant- (a) is acting in good faith; (b) appears prepared and able to sustain the proceedings; and (c) has alleged facts which, if proved, would support an order in terms of subsection’.¹⁷⁶ A company cannot implement a transaction that which is the subject of a pending application.¹⁷⁷ The onus of proving good faith rests on the applicant. He should present all known facts that he has acquired and clearly state reasons why he disapproves of the transaction and why he has not voted.

On reviewing a resolution, the court can set aside it on either substantive grounds if ‘the resolution is manifestly unfair to any class of holders of the company’s securities’ or on procedural grounds if ‘the vote was materially 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’.¹⁷⁸ The rights shareholders have under section 115 of the new Act in terms of requesting a court review of the transaction, is in some cases an addition to their appraisal rights in section 164.¹⁷⁹

These additional rights given to shareholders can be seen as an impediment to these transactions as there could be significant challenges to them and as a result numerous

¹⁷⁴ Section 115(5) of the new Act.

¹⁷⁵ Davids, Norwitz & Yuill op cit note 10 at 348.

¹⁷⁶ Section 115(6) of the new Act.

¹⁷⁷ Kevin Cron . ‘Mergers and Acquisitions: Capital Protection Special Report QE 1’. Accountancy SA. July 2010. Pg 3-48 at 15.

¹⁷⁸ Section 115(7) of the new Act.

¹⁷⁹ Davids, Norwitz & Yuill op cit note 10 at 347.

delays in the implementation of the transaction while those disputes are being resolved.¹⁸⁰

4.2) Analyses of section 116- Implementation of an amalgamation or merger

This section will analyse what a company needs to do if they are to implement the merger or amalgamation. I will also look at whether the legislatures have achieved their goal of creating a speedier and efficient procedure. I will also look at any problems within this procedure as well as discuss the procedure a company will follow.

In terms of section 116(1), once there has been shareholder or court approval (depending on the circumstances) from each of the merging companies, the final step before implementation can take place, is to give notice to every known creditor of each of the participating companies and any creditor 'within 15 business days after delivery of the notice, a creditor may seek leave to apply to a court for a review of the amalgamation or merger only on the grounds that the creditor will be materially prejudiced by the amalgamation or merger'; and a court may grant leave only if it is satisfied that '(i) the applicant for leave is acting in good faith; (ii) if implemented, the amalgamation or merger would materially prejudice the creditor; and (iii) there are no other remedies available to the creditor.'¹⁸¹ If a creditor or creditors have not objected to the merger within the specified time, then the merger can be implemented. 15 business days is not enough adequate time for creditors to reply. The number of days to reply should be increased to a minimum of 20 days. In certain companies many of the creditors are not based in South Africa which would mean that there could be numerous amounts of delays in the implementation process.

A notice of merger must be lodged with the Companies Commission stating that all the requirements of the new Act have been complied with and that any other compulsory regulatory approvals such as Competition approval have been approved

¹⁸⁰ Kevin Cron . 'Mergers and Acquisitions: Capital Protection Special Report QE 1'. Accountancy SA. July 2010. Pg 3-48 at 15.

¹⁸¹ Section 116(1)(b)-(c).

and along with the 'Memorandum of Incorporation of any company newly incorporated in terms of the agreement'.¹⁸² Once the Commission receives such notice, it will then go ahead and issue a registration certificate for each of the companies to be incorporated, whilst at the same time deregistering each of the merged companies which are not intended to survive the transaction and with the merger goes forth in accordance with the agreed terms and conditions.¹⁸³

If there are any shares in a merging entity that are held by or on behalf of another merging entity, the new Act provides that the agreement (under subsection 113(2)) must 'provide for the cancellation of those securities when the amalgamation or merger becomes effective, without any repayment of capital in respect thereof, and no provision may be made in the agreement for the conversion of those securities into securities of an amalgamated or merged company'.¹⁸⁴ This provision is used to prevent the merged entity from holding shares in itself and as a result effectively reducing the capital therefrom.¹⁸⁵ Section 116(6) (b) provides that a merger or amalgamation will take effect in accordance with all the conditions set out in the amalgamation or merger agreement and does not affect any:

existing liability of a party to the agreement, or of a director of any of the amalgamating or merging companies, to be prosecuted in terms of any applicable law; civil, criminal or administrative action or proceeding pending by or against an amalgamating or merging company, and any such proceeding may continue to be prosecuted by or against any of the amalgamated or merged company; or conviction against, or ruling, order or judgment in favour of or against, an amalgamating or merging company, and any such ruling, order or judgement may be enforced by or against any of the amalgamated or merged, company¹⁸⁶

Therefore the use of an amalgamation or merger cannot be used as an escape mechanism so as to avoid any type of liability as well as it has the positive effect of protecting all of the creditors involved in the company or companies. Upon the implementation of a merger, *all* (my emphasis) of the assets and liabilities are transferred to the merged company or companies by operation of law meaning that the merger procedure will now help companies to avoid the costs and legal formalities which are normally needed for the transfer of a company from one entity

¹⁸² Section 116(4) of the new Act.

¹⁸³ Section 116(5) and Section 116(6)(a) of the new Act.

¹⁸⁴ Section 113(3) of the new Act.

¹⁸⁵ Davids, Norwitz & Yuill *op cit* note 10 at 347.

¹⁸⁶ Section 116(6) (b) of the new Act.

to another, as well as reducing the amount of time for transferring items such as intellectual property and immovable property.¹⁸⁷ This must be read with section 116(8) which stipulates that ‘...any property that is registered in terms of any public regulation is to be transferred from an amalgamating or merging company to an amalgamated or merged company, a copy of the amalgamation or merger agreement, together with a copy of the filed notice of amalgamation or merger, constitutes sufficient evidence for the keeper of the relevant property registry to effect a transfer of the registration of that property’. It is safe to assume that property (as there is no definition provided for in the new Act) includes incorporeal and corporeal property.¹⁸⁸ A definition should be provided when amendments are made.

Section 116(9)¹⁸⁹ provides that ‘any party to whom assets or a business is to be transferred (*inter alia*, as part of a merger) can, once it has been approved by the shareholders, apply to court for an order to give effect to the transaction, which can, *inter alia*, include an order to transfer the relevant undertaking, assets or liabilities, an order to transfer shares from one person to another or an order dissolving any of the merging companies which was intended to be dissolved as part of the transaction’.¹⁹⁰

This is probably intended to allow a party to a transaction, a method to enforce the transaction if the other party refuses, for any reason, to give effect to the merger agreement after the requisite shareholder approval has been obtained.¹⁹¹ Section 116 at present does not seem to present any difficulties. Only once the new Act is enacted

¹⁸⁷ Davids, Norwitz & Yuill op cit note 10 at 347.

¹⁸⁸ Davids, Norwitz & Yuill op cit note 10 at 349.

¹⁸⁹ ‘(9) If, with respect to a transaction involving a company that is regulated in terms of the Banks Act, there is a conflict between a provision of subsection (7) and a provision of section 54 of that Act, the provisions of that Act prevail’ and ss 7 “When an amalgamation or merger agreement has been implemented—

(a) the property of each amalgamating or merging company becomes property of the newly amalgamated, or surviving merged, company or companies; and

(b) each newly amalgamated, or surviving merged, company is liable for all of the obligations of every amalgamating or merging company subject to subsection (8), the requirements of section 113(1), and any provision of the merger agreement, or any other agreement”.

Section 113(1) states that “Two or more profit companies, including holding and subsidiary companies, may amalgamate or merge if, upon implementation of the amalgamation or merger, each amalgamated or merged company will satisfy the solvency and liquidity test.’

¹⁹⁰ Davids, Norwitz & Yuill op cit note 10 at 352.

¹⁹¹ *Ibid.*

and mergers are being implemented will we see if the implementation process has any flaws.

CHAPTER 5- Contracts and Mergers

5.1) Contract law and Mergers

Section 116(7) sets out that once an amalgamation or merger has been implemented the 'property of each amalgamating or merging company becomes property of the newly amalgamated, or surviving merged, company or companies'. This therefore includes that the newly amalgamated or survived merged company is still liable for all the obligations of every amalgamating or merged company subject to the requirements of section 113(1) as well as the merger agreement and any other agreement.¹⁹²

But what is meant by 'any other agreement'? The general rule is that all the liabilities of the merging companies are then assumed by the survived merged company and making it subject to 'any other agreement' and not providing any examples or specific agreements can result in potential confusion.¹⁹³ As a result of any qualifying provision or definition of 'any other agreement', any question with regard to the question of the 'transfer of contracts to which the merging entities were parties would be a matter of interpreting the specific contracts implicated especially with regard to contracts that were entered into before the merger statute was enacted'.¹⁹⁴ Therefore contracts between a survived merged company and third parties will still be intact because there has been no change of the parties.

If a contract is silent on assignability, the obligations of that contract will vest in the survived company, even without the consent of the third party.¹⁹⁵ The reason being that the assumption would thus not take place by assignment, but by operation of law and a review of the provision shows that there is nothing 'prohibiting assignment without consent would prevent the merged entities assuming rights and obligations

¹⁹² Section 116(7) (b) of the new Act.

¹⁹³ Davids, Norwitz & Yuill op cit note 10 at 349.

¹⁹⁴ Davids, Norwitz & Yuill op cit note 10 at 350.

¹⁹⁵ Cassim op cit note 19 at 5.

under the contracts.¹⁹⁶ There is an ongoing debate with regard to the extent to which an agreement seeks to disallow cession of a right (*pactum de non cedendo*) is enforceable.¹⁹⁷ There is authority that suggests that any such agreement ‘should only be enforceable only if the debtor has a genuine interest in prohibiting such cession’¹⁹⁸. To the extent that such an agreement is enforceable, it however appears that it does not prevent ‘involuntary transfers by operation of law’ as this would be the scenario for mergers.¹⁹⁹ Cassim states that ‘where contracts expressly determine that it is non-assignable without consent in the event of change of control, it would also vest in the new surviving amalgamated or merged entity on the basis that a non-assignability clause, intended to apply to cessions or assignment, is not intended to apply to a transfer by the operation of law’.²⁰⁰ An example would be ‘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’²⁰¹. This is a cause for concern as third parties are not protected. A remedy that could be used to amend future contracts would be to specifically provide that a ‘contract will not survive an amalgamation or merger’.²⁰² This would then allow contracts from being vested in the survived merged company.

Personal contracts cannot be transferred without performance by the third party and this same principle is applicable to agreements such as intellectual property rights and patent licences, especially if they are ‘non-transferable or non-assignable without the consent of the licensor’.²⁰³ Cassim explains that ‘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.

¹⁹⁶ Davids, Norwitz & Yuill op cit note 10 at 350.

¹⁹⁷ PM Nienaber ‘Cession’. LAWSA vol 2 part 2 (2003) at 28–30 and SE van der Merwe *Contract: General Principles* 3 ed. (2007) at 473–4.

¹⁹⁸ van de Merwe op cit note 198 at 473–4.

¹⁹⁹ Nienaber op cit note 198 at 28–30 n 15 and van de Merwe op cit note 198 at 474 n 175.

²⁰⁰ Cassim op cit note 19 at 5.

²⁰¹ Ibid.

²⁰² Bouwman op cit note 102 at 34.

²⁰³ Ibid.

The use of the reverse triangular merger plays a fundamentally important role in such circumstances.²⁰⁴

It is the right of the contracting parties to agree on how they will terminate their contracts or the use of any other remedies in the event of the contract being taken over by another party or parties because of the merger or a change of control.²⁰⁵ A matter beyond the scope of this paper is that a party can agree that it will not merge or suffer under the new control, and the party then has a remedy under contract law and not that of company law.²⁰⁶

In the new Act, reference is made to the assumption of obligations being subject to 'any other agreement'. This raises questions as to 'what liabilities may be assumed in the merger by operation of law'.²⁰⁷ This reference could mean that the merger statute does not vitiate contracts, but to the extent 'that the 'other agreement' provides that it will for example, terminate upon a merger taking place, it shall so terminate and the obligations will not be assumed by the merged entity'.²⁰⁸

Dauids, Norwitz and Yuill do not believe that 'the provision is intended to allow parties, as a matter of law, to contract out of the legal consequences of a merger, including the automatic assumption by the merged entity of all rights and obligations of the merging entities'.²⁰⁹ This means that if a company is a party to a contract that provides specific rights or obligations that terminate if it engages or enters into a merger the consequences, ie-termination of rights and obligations, are provided for in contract law and the statute had no need in specifying that the 'assumption of merging parties' obligations in a merger is 'subject to any other agreement'.²¹⁰ Section 116(7)(b) is clearly ambiguous and clarification on what 'making the assumption of obligations subject to any other agreement' means would provide less

²⁰⁴ Cassim op cit note 19 at 6.

²⁰⁵ Davids, Norwitz & Yuill op cit note 10 at 350.

²⁰⁶ Ibid.

²⁰⁷ Ibid.

²⁰⁸ Ibid.

²⁰⁹ Ibid.

²¹⁰ Davids, Norwitz & Yuill op cit note 10 at 350.

confusion.²¹¹ Another aspect worth noting is that although the new Act clearly provides that ‘the merged entity or entities assume the obligations of the merging entities’, the act does not anywhere specifically provide that the merged entity or entities will automatically form part of or take over the contracts of the merging entities and acquire rights as they would have under such agreements.²¹²

‘Contractual rights are the property of the right holder’ and read with Section 116(7)(a) will thus become the property (ie-the rights) of the merged entity or entities, however the transfer of obligations in terms of section 116(7)(b)²¹³ which are subject to certain qualifications.²¹⁴ Unlike section 116(7)(a) in which the transfer of property is not It would have been preferable if the new act dealt with the transfer of contracts, which include rights and obligations, as a separate provision and ‘specifically confirm that the merged entity or entities would replace the merging entities as parties to whatever agreements the merging agreements were party to by operation of law, and assume both the rights and obligations of the merging parties under those agreements (subject to any termination rights or other remedies that the other contracting party may have)’.²¹⁵ The transfer of insurance contracts will now need to be regulated, the reason being that they now own a larger amount of assets and that their risk profile has changed.

²¹¹ Ibid.

²¹² Davids, Norwitz & Yuill op cit note 10 at 351.

²¹³ Section 116 of the new Act. ‘(1) Subject to subsection (2), after a resolution approving an amalgamation or merger has been adopted by each company that is a party to the agreement, and the transaction has satisfied all of the applicable requirements set out in section 115— (a) each of the amalgamating or merging companies must cause a notice of the amalgamation or merger to be given in the prescribed manner and form to every known creditor of that company; (b) within 15 business days after delivery of a notice required by paragraph (a), a creditor may seek leave to apply to a court for a review of the amalgamation or merger only on the grounds that the creditor will be materially prejudiced by the amalgamation or merger.’

²¹⁴ Davids, Norwitz & Yuill op cit note 10 at 351.

²¹⁵ Ibid.

CHAPTER 6- Shareholder Remedies

6.1) Dissenting Shareholders Appraisal Rights

The number one measure provided in the new Act, in terms of a statutory merger, is not a court sanction, but the appraisal right for shareholders. This new concept introduced into our law has its roots in the USA from at least 1865.²¹⁶ Dissenting shareholders appraisal rights equivalent section could be found in the catch all phrase in the former companies Act s252²¹⁷ but that is a different remedy afforded to the shareholder for oppression by the majority through unfairly prejudicial, unjust and unfair conduct by the majority. Of particular importance is s252(3), which allows the court to give an order to wind up the company or make any order it deems fit which may include *inter alia* the purchase of the aggrieved minorities shares. It says nothing about fair value or fair market value.

The appraisal remedy in s164 allows one to obtain the fair value of their shares if the company embarks on one of the following transaction namely s112 (disposals), s113 (mergers) and s114 (schemes of arrangement) or the alteration of the MoI regarding alteration of shares. Section 164 is triggered if the company enters into one of the above transactions. Another aspect of section 252 is that it also has its equivalent in section 163 of the Act. So section 163 (former section 252) finds wider application in comparison to the appraisal which can only be utilized in the aforementioned situations. Rawood states that 'few companies will be willing to undertake merger and acquisition activity unless they know that there will be no dissenting shareholder' and also is of the view that 'this will be impossible in the case of listed companies with hundreds or thousands of shareholders ... the financial impact of

²¹⁶ H.H.H. 'Corporations-Statutory Right of Dissenting Stockholders to Obtain Appraisal and Purchase of Shares'. Virginia Law Review Vol 16 no 5 (Mar 1930) p 484 at 486. A statute in Pennsylvania provided for this right as far back as 1865.

²¹⁷ Relief from Oppression (s 252) and Section 252- Member's remedy in case of oppressive or unfairly prejudicial conduct.

having to make payment of fair value may well cripple companies.²¹⁸

This is a new concept in South African law. It is based on a similar protection provided for in American Corporate law, but it has not been adopted in its entirety. Certain aspects have been left out like the Delaware ‘market out’ approach which provides that ‘appraisal rights are not available if target company shareholders are receiving only publicly traded stock in consideration for their shares’.²¹⁹ The remedy has been modified for the South African context. The appraisal right has been 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’.²²⁰ Fair value has not been given a definition.

The appraisal rights procedure provided in section 164 of the new act effectively ‘grants a put option to dissatisfied shareholders in the event of certain transactions being undertaken by the company with which they disagree, entitling them to require the company to acquire their shares at fair value’.²²¹ This does not only apply to a merger transaction but also to a scheme of arrangement, asset disposal, and any changes to the Memorandum of Incorporation which will materially affect the rights of shareholders²²² as well as providing ‘shareholders both with a means of exit and, in the context of a scheme of arrangement or merger, with a means of challenging the adequacy of the consideration that they have received for their shares’.²²³ The appraisal therefore gives dissenting shareholders a right to claim fair value of their shares. These shareholders normally have no legal basis to prevent a merger that has

²¹⁸ Ilham Rawoot . ‘Companies Act Farce’ available at <http://www.mg.co.za/article/2010-04-07-companies-act-farce>, accessed on 9 April 2010.

²¹⁹ Davids, Norwitz & Yuill op cit note 10 at 351.

²²⁰ Allen & Kraakman op cit note 57 at 452.

²²¹ Davids, Norwitz & Yuill op cit note 10 at 351.

²²² Section 164(2) of the new Act “(2) If a company has given notice to shareholders of a meeting to consider adopting a resolution to—

(a) amend its Memorandum of Incorporation by altering the preferences, rights, limitations or other terms of any class of its shares in any manner materially

adverse to the rights or interests of holders of that class of shares, as contemplated in section 37(8); or

(b) enter into a transaction contemplated in section 112, 113, or 114, that notice must include a statement informing shareholders of their rights under this section.”

²²³ Cassim op cit note 19 at 19.

been approved by the requisite amount of shareholders, except in certain circumstances where the court needs to approve the merger.²²⁴

6.2) Procedure for exercising appraisal rights

A shareholder ‘may’ and not must (but presumably they are implying a must) give the company written notice in which he objects to the resolution in terms of section 164(2)²²⁵ and the shareholder must then vote against the resolution at the shareholders meeting.²²⁶ Once a company has adopted a resolution, the company must then ‘send a notice that the resolution has been adopted to each shareholder who— (a) gave the company a written notice of objection in terms of subsection (3); and (b) has neither-(i) withdrawn that notice; or (ii) voted in support of the resolution’.²²⁷

If the resolution is passed, the company then must inform the dissenting shareholders that they 20 days to demand, if it is their wish, they be paid by the company the fair value of their shares.²²⁸ There is currently no definition or explanatory note provided for ‘fair value’ in the new Act and as a result the courts will have to delve in this matter. This is discussed in chapter 7 below.

A shareholder who has sent a demand in the prescribed way has no further rights in those shares other than to be paid their fair value unless ‘ the shareholder withdraws that demand before the company makes an offer under subsection (11), or allows an offer made by the company to lapse, as contemplated in subsection (12)(b); the company fails to make an offer in accordance with subsection (11) and the shareholder withdraws the demand; or the company revokes the adopted resolution that gave rise to the shareholder’s rights under this section’.²²⁹ This means that the company is then required to make an offer to the dissenting shareholders to acquire

²²⁴Section 164 of the new Act.

²²⁵ Section 164(3) of the new Act.

²²⁶ Section 164(5)(c) of the new Act.

²²⁷ Section 164(4) of the new Act.

²²⁸ Section 164(7) and s 164(8) of the new Act.

²²⁹ Section 164(9) of the new Act.

their shares after the board has decided what a fair value would be²³⁰ and every offer made ‘in respect of shares of the same class or series must be on the same terms; and lapses if it has not been accepted within 30 business days after it was made’.²³¹

If the shareholder accepts the offer made, the shareholder must then tender the relevant shares so that they can be acquired by the company²³² the company must pay the agreed amount to the shareholder within 10 business days after the shareholder has accepted the offer and tendered his shares.²³³ If company fails to make an offer or makes an offer in which the shareholder believes to be inadequate, the affected shareholder or shareholders are allowed to apply to court so as to have the court determine the fair value of the shares and making an order for the company to pay the shareholder the fair value determined by them.²³⁴ ‘The fair value in respect of any shares must be determined as at the date on which, and time immediately before, the company adopted the resolution that gave rise to a shareholder’s rights under this section’.²³⁵

The court then has the following duties:

the court... (i) may determine whether any other person is a dissenting shareholder who should be joined as a party; (ii) must determine a fair value in respect of the shares of all dissenting shareholders, subject to subsection (16); (iii) in its discretion may— (aa) appoint one or more appraisers to assist it in determining the fair value in respect of the shares; or (bb) allow a reasonable rate of interest on the amount payable to each dissenting shareholder from the date the action approved by the resolution is effective, until the date of payment; (iv) may make an appropriate order of costs, having regard to any offer made by the company, and the final determination of the fair value by the court; and (v) must make an order requiring— (aa) the dissenting shareholders to either withdraw their respective demands, in which case the shareholder is reinstated to their full rights as a shareholder, or to comply with subsection (13)(a); and (bb) the company to pay the fair value in respect of their shares to each dissenting shareholder who complies with subsection (13)(a), subject to any conditions the court considers necessary to ensure that the company fulfils its obligations under this section²³⁶

²³⁰ Section 164(11) of the new Act.

²³¹ Section 164(12) of the new Act.

²³² Section 164(13)(a) of the new Act.

²³³ Section 164(13)(b) of the new Act.

²³⁴ Section 164(14) of the new Act.

²³⁵ Section 164(16) of the new Act.

²³⁶ Section 164(c) of the new Act.

The court will then decide the matter and make an order in what in fact constitutes fair value of the shares.²³⁷ In most of the US states, the appraised value is specified as ‘the fair value of the shares on a going concern basis without giving effect to the contemplated transaction, so that the shareholder asserting appraisal rights is not entitled to the control premium inherent in a takeover price but may receive more or less than the deal price’.²³⁸ If there are reasonable grounds to believe that a company is unable to comply with the court orders or ‘would result in the company being unable to pay its debts as they fall due and payable for the ensuing 12 months’, the company may then apply to court for ‘an order varying the obligations’ and the court may then make an order that is ‘is just and equitable, having regard to the financial circumstances of the company; and ensures that the person to whom the company owes money in terms of this section is paid at the earliest possible date compatible with the company satisfying its other financial obligations as they fall due and payable’.²³⁹ To ‘the extent that the merging company in which the shareholders exercising their appraisal rights held shares no longer exists as a result of the merger, the obligations will pass to the new merged entity/ies’.²⁴⁰ Since the courts have very limited involvement in the actual merger process, the appraisal rights procedure provides a safeguard for shareholders if the merging companies. Courts will in the immediate future have to determine what fair value is.

6.3) Minority Shareholder Rights

This section was introduced with the clear intention to protect minority shareholders in the given circumstances mentioned above. From a dissenting shareholders point of view, this section gives them a right to, in certain circumstances, ‘force the sale of their shares’.²⁴¹ The rationale behind giving dissenting shareholders an opportunity to force the sale of their shares just because they disagree with a decision or decisions of the majority is unclear.²⁴² The appraisal rights procedure can be seen as a suitable

²³⁷ Section 164(15)(c)(ii) of the new Act.

²³⁸ Davids, Norwitz & Yuill op cit note 10 at 353 at footnote 49.

²³⁹ Section 164(17) of the new Act.

²⁴⁰ Davids, Norwitz & Yuill op cit note 10 at 353 and Section 164(18) of the new Act.

²⁴¹ Cron op cit note 178 at 16.

²⁴² Ibid.

exit mechanism to the transactions, but by virtue of being a minority shareholder in a company, it means that certain decisions taken against you is out of your hands, whilst 'shareholders that do not wish to run the risk of the majority of shareholders taking a decision with which they disagree, should not be minority shareholders'.²⁴³ It is a growing concern that the granting of rights to the minority at the conclusion of a transaction could have the effect that it could 'severely inhibit corporate activity'.²⁴⁴ A company runs the risk of paying an undetermined amount of money to the minority shareholders upon entry into the transaction which makes it extremely problematic in the planning of a fundamental transaction.²⁴⁵ Cron states that 'unless the risk of appraisal rights being exercised can be clearly quantified, a company will be uncertain in many instances whether it will be called upon in terms of section 164 of the Act and, if so, the amount of its financial obligations which will arise as a result thereof'.²⁴⁶

This clearly makes the evaluation of a transaction and the raising of amount (if quantified and known) to fund a transaction virtually impossible, and in most instances 'standby funding' will have to be organised if the appraisal rights are being exercised therefore adding to the transaction costs.²⁴⁷ The concept of 'fair value' is still an uncertain area within our law and it adds to the difficulty of evaluating the financial consequences of a transaction.²⁴⁸ This is a liberal approach in contrast to the conservative approach followed before the new Act in favour of minority shareholders.²⁴⁹ The courts when dealing with this section must exercise extreme caution in order to avoid an abuse of section 115. The legislature has achieved its goal of protecting minority shareholders, but at what cost. Yes, it is helping with company law reform, but at the same time it should not stifle a 'flexible and dynamic economy' as this could prove to be a barrier for corporate activity and therefore

²⁴³ Ibid.

²⁴⁴ Ibid.

²⁴⁵ Ibid.

²⁴⁶ Ibid.

²⁴⁷ Ibid.

²⁴⁸ Ibid.

²⁴⁹ Bouwman op cit note 102 at 33. S 440K requires 90% shareholder approval. S311 requires 75% of votes exercisable by members

directly affecting company's shareholders.²⁵⁰ Unfortunately, the appraisal remedy has the limited function of only being a remedy for minority shareholders²⁵¹. It is clear that neither 'the personal action at common law nor the oppression remedy can be equated to the appraisal remedy'.²⁵² Revision of the protection of minority shareholders is needed but at the same time the introduction of this remedy is welcomed.

²⁵⁰ Cron op cit note 178 at 16.

²⁵¹ HGJ Beukes. 'An Introduction to the Appraisal Remedy as Proposed in the Companies Bill: Triggering Actions and the Differences between the Appraisal Remedy and Existing Shareholder Remedies.' (2008) 20 *SA Merc LJ* 479-495 at 494.

²⁵² *Ibid.* 'In terms of s 440K(3) of the Companies Act as well as rule 8 of the Securities Regulation Code on Take-overs and Mergers, an offeror can be forced to buy a shareholder's shares in certain circumstances. As the appraisal remedy places the obligation to buy shares from dissenting shareholders on the company, neither s 440K(3) nor rule 8 constitutes an appraisal remedy'.

CHAPTER 7-

Protection of Shareholders before the Implementation of a Merger

7.1) Protection of shareholders

This chapter will show the manner in which the new Act ensures that the interests of shareholders are protected during a merger or amalgamation procedure and the efficiency of each measure. Furthermore I will concentrate on the following key measures which are: requirement for shareholder approval, the ability of shareholders to have a court review the transaction in certain circumstances, the fiduciary duties of directors to provide further shareholder protection and the appraisal rights remedy. I shall also look at the extent to which a shareholder may be able to benefit from the remedy provided in section 163(relief from oppressive or prejudicial conduct) of the new Act.

7.1.1) Shareholder Approval

Cassim concluded upon analyses of the Companies Bill that the protective measures for shareholders were ‘fundamentally flawed’ and was described as ‘inordinately permissive and lenient’.²⁵³ In terms of the Bill, ‘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’²⁵⁴. From this it can be established that both the quorum and the prescribed shareholder approval relate to the number of shares and not to the number of shareholders at the meeting.

In terms of section 115(2) of the new Act, ‘any merger transaction is required to be approved by a special resolution passed at a meeting of shareholders at which shareholders representing at least 25 percent of the voting rights are present’. In this Act however, it does not provide for any separate class voting in terms of a merger transaction (if separate classes of shares exist) and that quorum and shareholder approval requirements are applicable to all shareholders who have voting rights and

²⁵³ Cassim op cit note 19 at 8

²⁵⁴ Clause 119 of the Companies Bill

it also fails to take into account shareholders who do not have voting rights in the relevant transaction²⁵⁵. Such shareholders would want to seek some form of protection with regard to their shares. The eligible shares which may be voted on, in terms of clause 119(8) of the Bill, 'are voting shares, 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'.²⁵⁶ Voting shares is defined in the new Act 'with respect to any matter to be decided by a company, means— (a) the rights of any holder of the company's securities to vote in connection with that matter, in the case of a profit company; or (b) the rights of a member to vote in connection with the matter, in the case of a non-profit company'.²⁵⁷ Voting shares are not defined in the act. Under Canadian Law 'each share carries a right to vote on a proposed amalgamation even though it is otherwise a non-voting share'.²⁵⁸

Under an earlier draft of the new Act, it was proposed that 'a simple majority of the shares voted would be sufficient to approve a merger', however given the general nature of these transactions, there is a possibility that minority shareholders can be expropriated and that any decision with regard to the policy must stay with the requirement of a special resolution for fundamental transactions.²⁵⁹ The shareholder approval requirement means that 'if the quorum at the meeting of shareholders in respect of an *arms length* merger 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'.²⁶⁰ The new Act as can be seen as in favour of dominant majority shareholder and against the numerical majority.²⁶¹ The majority shareholders need not even hold as much as 51 percent of a company's shares so as

²⁵⁵ Davids, Norwitz & Yuill op cit note 10 at 355.

²⁵⁶ Clause 1 of the Companies Bill.

²⁵⁷ Section 1 of the new Act.

²⁵⁸ Section 183(3) of the Canada Business Corporations Act, 1985.

²⁵⁹ Davids, Norwitz & Yuill op cit note 10 at 356.

²⁶⁰ Cassim op cit note 19 at 9.

²⁶¹ Ibid.

to be able to approve or veto a merger on the strength of his vote alone.²⁶² Due to shareholder apathy, many minority shareholders in large companies, with each a small holding, do not attend meetings and as a direct result do not cast their votes.²⁶³

The new Act allows a company (if the Memorandum of Incorporation permits) to lower the 'percentage of voting rights to approve any special resolution; or one or more lower percentages of voting rights to approve special resolutions concerning one or more particular matters, respectively, provided that there must at all times be a margin of at least 10 percentage points between the requirements for approval of an ordinary resolution, and a special resolution, on any matter'.²⁶⁴ It is conceivable that a vote of as little as 12.5 per cent of a company's shares would be enough to approve 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').²⁶⁵ This can be problematic for public companies where large blocks of its shares are held by institutional shareholders.²⁶⁶ As a result of the lenient shareholder threshold and the favouring of controlling shareholders, shareholders are not given adequate protection in an arms length merger.²⁶⁷ The Bill was even more lenient than the amendments in the American Model Business Corporation Act in 1999. The amendments sought to reduce 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)'.²⁶⁸ This means that under this act, a vote of 25 percent or more is sufficient for a merger, unlike South Africa where 12.5 percent would be sufficient for a proposed merger.

In terms of the Companies Bill, it is submitted that although the absolute majority vote is a good concept, it will be not viable in a South African context as 'it may make the approval and effectuation of mergers difficult to accomplish in practice,

²⁶² Ibid.

²⁶³ Ibid.

²⁶⁴ Section 65(10) (a)-(b) of the new Act.

²⁶⁵ Cassim op cit note 19 at 9.

²⁶⁶ Cassim op cit note 19 at 9. It is a shareholder which is itself a company rather than an individual.

²⁶⁷ Cassim op cit note 19 at 10

²⁶⁸ s 11.04(e) of the Model Business Corporation Act, 1984, as amended.

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'.²⁶⁹ These thresholds are currently being used in Canada and New Zealand.

A balance however needs to be struck between the protection of minority shareholders and economically sound transactions, but also not to overly empower the minority shareholders so as to have them holding up transactions against the wishes of the majority and it is that reason why Davids believes that 'permitting a degree of private ordering is appropriate'.²⁷⁰ The quorum requirement is 25 per cent of the voting rights in South Africa, unlike other jurisdictions which require a higher quorum, like the United States that need 50 per cent of the outstanding shares.²⁷¹ This South African standard ensures that a significant amount of shareholders participate at the meeting and allows for meetings to be constituted properly.²⁷²

Shareholder approval is needed from all of the merging companies.²⁷³ This is very appropriate as these types of transactions have a significant effect on all those involved. Is this however necessary in all circumstances? In many jurisdictions the approval of the acquiring firms shareholders are not needed when the acquirer is much larger than the target firm on the basis that they constitute a small purchases for tax or other reasons structured as a merger and would therefore have no impact on the acquiring firms shareholders.²⁷⁴

It is possible to avoid unnecessary voting by using the reverse triangle merger as defined above. An example is:

... if a buyer (B) desires to acquire target (T) for 10 per cent of its shares. Using the reverse triangular merger structure, B would drop a merger subsidiary (S) that would merge into T, with T surviving the merger as a wholly owned subsidiary of B and T's shareholders receiving 10 per cent of B's shares. T's shareholders would of course have to approve the

²⁶⁹ Cassim op cit note 19 at 10.

²⁷⁰ Davids, Norwitz & Yuill op cit note 10 at 356.

²⁷¹ Ibid.

²⁷² Ibid.

²⁷³ Section 115 of the new Act.

²⁷⁴ Davids, Norwitz & Yuill op cit note 10 at 357.

transaction. So too would S's shareholder, but that is only B itself. B's shareholders would not have to approve the transaction in this scenario because B is not a party to the merger (unless of course the issuance of shares requires a vote by law or under stock exchange rules).²⁷⁵

Another area which can be questioned with regard to shareholder approval is in the context of internal group reorganisations of mergers between holding companies and their subsidiaries or between two subsidiaries 'where there are no minority shareholders, and creditors are less likely to be prejudiced, and a simpler procedure requiring only board approval may be justified'.²⁷⁶ In the United States, when a company has a 90 per cent stock of another company, it can implement a short form merger to squeeze out minority shareholders without having the minority shareholders vote, however the directors owe a fiduciary duty of fairness to the minority and the courts when reviewing the transactions will look for fairness.²⁷⁷ In this regard, we have section 112(proposals to dispose of all or greater part of assets or undertaking) of the new Act which clearly states that requirements of this section will not apply within the context of disposals 'between or among— (i) two or more wholly-owned subsidiaries of the same holding company; or (ii) a wholly-owned subsidiary of a holding company, on the one hand, and its holding company and one or more wholly-owned subsidiaries of that holding company, on the other hand'.²⁷⁸ The legislators should have used this basic structure and applied it within the context merger.

Section 115(4) states:

'...any voting rights controlled by an acquiring party, a person related to an acquiring party, or a person acting in concert with either of them, must not be included in calculating the percentage of voting rights— (a) present in satisfaction of the quorum requirement; or (b) voted in support of a resolution'. This requirement is aimed at protecting minority shareholders where the transactions is 'not an arms-length one, and the acquirer stands on both sides of the transaction'.²⁷⁹

²⁷⁵ Ibid.

²⁷⁶ Ibid.

²⁷⁷ Ibid.

²⁷⁸ Section 112(c) of the new Act.

²⁷⁹ Davids, Norwitz & Yuill op cit note 10 at 357.

This is a familiar concept in South African M&A activity. It can be found in Rule 10.4(e) of the Related Party provisions in the JSE Listing Requirements²⁸⁰ and the ‘whitewash provisions’ for a mandatory offer in terms of Rule 8.7.

In American practice, shareholders of a company are allowed, when engaging in a transaction to vote ones shares, but ‘subjects’ transactions involving control shareholders to heightened judicial scrutiny to ensure that they are fair to minority shareholders’.²⁸¹ Any rule that impacts on the rights of owning shares will have an impact on economic activity of the company such as discouraging ‘prospective buyers from building stakes in potential target companies’.²⁸² Shareholders thus have a strong hand when negotiating with companies seeking to merge, disproportional as such. Davids goes on to state that it is ‘quite possible that this requirement(s)112) that any merger vote disregard the holdings of the acquiring party and all of its concert parties may discourage deal activity and undermine the benefits intended by the adoption of the statutory merger provisions, at least where related companies are involved’.²⁸³

Another concern is that an ‘acquiring party’ and ‘persons acting in concert’ are not defined for the purposes of this section. ‘Acting in concert’ is defined in section 117(1). It states “any action pursuant to an agreement between or among two or more persons, in terms of which any of them co-operate for the purpose of entering into or proposing an affected transaction or offer”. It only applies in the context of affected transactions.²⁸⁴ For the sake of clarity it would have been better if the legislators had set out specific definitions for these terms, although the in most cases it would be easy to identify who the ‘acquiring party’ or ‘persons acting in concert’ are.

²⁸⁰ ‘If an issuer, or any of its subsidiaries, proposes to enter into a related party transaction, or if the JSE determines that a transaction is a related party transaction, the issuer must: include in the ordinary resolution to approve or give effect to the transaction, a condition that the validity, for the purposes of the Listings Requirements, of the resolution will be subject to a simple majority of the votes of shareholders, other than the related party and its associates, being cast in favour of the resolution...’

²⁸¹ Davids, Norwitz & Yuill op cit note 10 at 357.

²⁸² Ibid.

²⁸³ Davids, Norwitz & Yuill op cit note 10 at 358. and ‘this is likely to prevent the so-called ‘second-step’ merger used in the United States, involving a tender offer, followed by a cash squeeze-out of the minorities who did not tender’.

²⁸⁴ Chapter 5 part C of the new Act.

What information is available to shareholders for the purposes of deciding whether to approve a merger or not? The board is required to under section 113(5) to provide shareholders with a copy or summary agreement of the amalgamation or merger agreement, but that's where it ends. The company does not have to provide shareholders with advice or recommendations regarding the transaction. In the United Kingdom, France and Germany, companies provide for an 'independent expert report' (as many matters involved in the transaction are complex) on the terms of the merger which is then presented to shareholders, unlike the United States which does not require a 'expert report' but rather the 'board of directors is generally required to make a recommendation to the shareholders as to how they should vote or respond to a tender offer and the recommendation of the board of directors is often supported by a 'fairness opinion' from a reputable investment bank'.²⁸⁵ These opinions can be used by directors as 'evidence of compliance with their fiduciary duties and their duty to exercise care and skill'.²⁸⁶ This type of report is required for a scheme of arrangement under the new Act and there seems to be no legitimate reasons as to why this type of reports should not be included for merger transactions.²⁸⁷ It would be beneficial to follow this approach as many shareholders in South Africa have fairly limited knowledge when it comes to such transactions and would be inline with the King III report for the advancement of shareholder activism. This may not be a major issue in the future that significant transactions will be considered 'affected transactions' and under part C of Chapter 5 a report will in most cases be required.

7.1.2) The Ability of Shareholders to have a Court Review of the Transaction(s)

The approval of a merger by a court is only required in certain circumstances for a statutory merger. Shareholders are only allowed to have a transaction reviewed in limited circumstances. Section 115(3) states that:

²⁸⁵ Davids, Norwitz & Yuill op cit note 10 at 359.

²⁸⁶ Cassim op cit note 19 at 17 and "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"

²⁸⁷ Davids, Norwitz & Yuill op cit note 10 at 359.

a company may not proceed to implement that resolution without the approval of a court if—(a) the resolution was opposed by at least 15% of the voting rights that were exercised on that resolution, and any person who voted against the resolution requires the company to seek court approval; or (b) the court, on an application by any person who voted against the resolution, grants that person leave, in terms of subsection (6), to apply to a court for a review of the transaction in accordance with subsection (7).

Any dissenting shareholder can apply to a court for review no matter how many shareholders voted against the resolution. A court will only grant leave to the applicant, only if it is satisfied that the applicant is ‘is acting in good faith; appears prepared and able to sustain the proceedings; and has alleged facts which, if proved, would support an order in terms of subsection (7)(setting aside a resolution)’.²⁸⁸

How effective is this remedy in practice for shareholders? The grounds on which a court can review or set aside a resolution is fairly limited. The grounds are that the ‘the resolution is manifestly unfair to any class of holders of the company’s securities; or the vote was materially 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’.²⁸⁹ These grounds appear to have set the bar quite high in order for a review to succeed and seem to be consistent the standard applied in other jurisdictions. In *Gimbel v Signal Cos*²⁹⁰, *Aronson v Lewis*²⁹¹ and *Smith v Van Gorkom*²⁹² the Delaware courts apply the ‘business judgement rule’ when reviewing challengers to mergers or similar type transactions, and as such ‘accords a high degree of deference to the decisions of unconflicted directors acting in good faith and with due care’²⁹³ and will only apply the ‘entire fairness’ standard of review only if there is a ‘conflict of interest or other inclination of bad faith’.²⁹⁴ Another factor that can be seen as limiting the effectiveness of judicial review as a form of shareholder protection is the fact that these proceedings may have a financial impact on the shareholder as this can be seen as a deterrent factor, although if the 15 per cent

²⁸⁸ Section 115(6) of the new Act.

²⁸⁹ Section 115(7) of the new Act.

²⁹⁰ 316 A2d 599 (Del Ch 1974)

²⁹¹ 473 A2d 805, 812 (Del 1984)

²⁹² 488 A2d 858 (Del 1985)

²⁹³ *Gimbel v Signal Cos* op cit note 388; *Aronson v Lewis* and op cit note 289 and *Smith v Van Gorkom* op cit note 290.

²⁹⁴ Davids, Norwitz & Yuill op cit note 10 at 359.

threshold was met, the company would have to initiate the review and as such would cover the cost of the proceedings.²⁹⁵ This remedy however is only available to those who voted against the transaction and not available to those shareholders that did not vote or were unable to vote against the resolution and as such they could be materially prejudiced by the transaction, like for example preference shareholders who do not have voting rights in particular transactions.²⁹⁶

7.1.3) Appraisal Rights Remedy

Is this an effective remedy for dissatisfied shareholders? The appraisal rights remedy is laid out in section 164 of the new Act. This remedy can be used as either or both an exit mechanism and a way of challenging the fairness of consideration offered for shares. This process has the potential for being costly, complicated and time consuming²⁹⁷. In order for a shareholder to exercise his rights he has to take a number of steps and follow the procedure correctly in order to exercise his appraisal rights. The shareholder is allowed to approach a court to determine the fair value of his shares but this might take awhile to determine and then be paid that amount and keeping in mind that once a shareholder has demanded this, he has no further rights in respect of those shares other than to receive payment unless ‘the shareholder withdraws that demand before the company makes an offer, or allows an offer made by the company to lapse; the company fails to make an offer and the shareholder withdraws the demand; or the company revokes the adopted resolution that gave rise to the shareholder’s rights under this section’.²⁹⁸

The cost of litigation is also seen a factor limiting and discouraging shareholders from exercising this remedy particularly shareholders with limited funds.²⁹⁹ The court has a discretion to award interest on the amount to be paid to the shareholder , but will this amount in fact be adequate compensation, especially in cases where the

²⁹⁵ Davids, Norwitz & Yuill op cit note 10 at 360.

²⁹⁶ Ibid.

²⁹⁷ Ibid.

²⁹⁸ Section 164(9) of the new Act.

²⁹⁹ Davids, Norwitz & Yuill op cit note 10 at 360.

court orders the shareholder to pay its own costs.³⁰⁰ Also one should bear in mind is how successful the South African courts will be in determining fair value of share and at the same time be able to develop a consistent methodology in dealing with these type of cases, so that companies and their shareholders can be at ease knowing that an accurate result will be achieved.³⁰¹ The new Act is quiet on how this is to be achieved, but it does allow for the ‘appoint one or more appraisers to assist it in determining the fair value in respect of the shares’.³⁰² South Africa should take heed of how the Delaware courts have handled this situation. In the US, the remedy was not used as it was time and cost consuming as well as there was an uncertainty of ‘ultimately receiving a better result than the deal price’.³⁰³

If a company is faced with a potentially long and costly court procedure, the company in most cases will ensure that they offer shareholders, who want to exercise their appraisal rights, fair value for those shares and both parties will want to reach an agreement so as to avoid litigation as far as possible.³⁰⁴ Davids suggests that ‘the existence of the appraisal rights remedy may have a significant benefit *ex ante*, by ensuring that companies do not enter into transactions which are not beneficial to minority shareholders and thus likely to encourage the exercise of appraisal rights. The flip side of the coin, of course, is that it may deter transactions which could be potentially valuable to the company’.³⁰⁵ Minorities have other protections available to them like the statutory derivative action under section 266 and the oppression remedy under section 252 of the current Companies Act. ‘The potential *ex ante* benefit of the appraisal rights remedy will also depend largely on its efficacy and the extent to which it minorities are able to successfully avail themselves of it’.³⁰⁶

Section 164(15) (c) (v) states:

On an application, the court— must make an order requiring (a) the dissenting shareholders to either withdraw their respective demands, in which case the shareholder is reinstated to their full rights as a shareholder; and (b) the company to pay the fair value in respect of their

³⁰⁰ Section 164(15)(c)(iv) and Section 164(15)(c)(iii)(bb) of the new Act.

³⁰¹ Davids, Norwitz & Yuill op cit note 10 at 360.

³⁰² Section 164(15)(c)(iii)(aa) of the new Act.

³⁰³ Davids, Norwitz & Yuill op cit note 10 at 360.

³⁰⁴ Davids, Norwitz & Yuill op cit note 10 at 361.

³⁰⁵ Ibid.

³⁰⁶ Ibid.

shares to each dissenting shareholder ..., subject to any conditions the court considers necessary to ensure that the company fulfils its obligations under this section.

There however exists an ambiguity in this section. It is not clear, in terms of the court order, whether 'it is in the dissenting shareholder's discretion to decide whether or not it wishes to withdraw its demand or tender its shares (and accept the judicially determined fair value), or whether in fact the court is entitled to make the decision and either order each dissenting shareholder to withdraw its demand or alternatively order it to tender its shares (and receive the fair value payment)'.³⁰⁷ The courts will favour the approach of granting a fair remedy instead of the literal reading of the section as it seems more logical and reasonable, although the view that the discretion lies with the shareholders seems fairer.³⁰⁸

A second ambiguity in section 164(15)(c)(v) is what is meant by 'reinstated (dissenting shareholder) to their full rights as a shareholder'. Davids interprets this within a merger context and states that 'dissenting shareholders which withdraw their demand will be reinstated to their full rights to be treated like any other shareholder *under the merger agreement* (including receiving cash or other consideration for their shares if that is what the merger agreement provides), and *not* that such a dissenting shareholder is entitled to remain a shareholder in the company after the merger'.³⁰⁹ The intent of the transacting parties will not be reached by using the latter interpretation and in most M&A transactions the buyer (the acquirer) wants to own 100 per cent of the targets shares and as such eliminate the minority shareholders.³¹⁰ This is similar to a scheme of arrangement and a mandatory squeeze out in a tender offer. Judicial clarification is needed on these ambiguities and the most important clarification as to who can 'withdraw the dissent or tender and accept fair value' decision. In so far as the courts have discretion to determine the outcome 'the risk of undermining the value of the merger structure is somewhat mitigated, since judges

³⁰⁷ Ibid.

³⁰⁸ Ibid.

³⁰⁹ Davids, Norwitz & Yuill op cit note 10 at 362.

³¹⁰ Ibid.

can be expected to apply a harsh remedy that undermines a basic purpose of the transaction only in a serious case of abuse'.³¹¹

If section 164(15)(c)(v) is interpreted to allow the court to give each dissenting shareholder a choice of withdrawing its demands and therefore being reinstated with its 'full rights as a shareholder' or tender its shares and have a court determine a fair value of their shares, but this would encourage 'shareholders to dissent from transactions and exercise appraisal rights as a 'no-lose' proposition, given that they can always withdraw their demand and receive the deal price if the fair value determined by the court turns out to be less than they were originally offered'.³¹² If 'full rights as a shareholder' is interpreted to mean that dissenters cannot be squeezed out, then the impact is greater as shareholders would then have the ability to choose from three options: 'staying in, getting judicially determined 'fair value' or taking the deal price (by simply dropping their appraisal proceeding)'.³¹³ A mitigating factor is that the courts have discretion in the awarding of costs and any shareholder found to have abused the process will then be subject to an adverse court order.³¹⁴ South Africa should have followed the Delaware model in this regard as it provides that a 'dissenting shareholder (which does not withdraw its request for appraisal and accept the deal price) will receive the judicially determined 'fair value''.³¹⁵

How useful will this appraisal rights remedy be in practice? The procedure is cumbersome, lengthy and costly, all seen as deterrent factors for shareholders and one must not forget ask whether the courts can deal with these cases efficiently and consistently, ensuring that this procedure is viable and encourages use of it.³¹⁶ A spin off from this is the fact that it will ensure that companies offer fair value for its shares from the start, thus not needing litigation and cutting down on costs.³¹⁷

³¹¹ Ibid.

³¹² Ibid.

³¹³ Davids, Norwitz & Yuill op cit note 10 at 362.

³¹⁴ Ibid.

³¹⁵ Ibid.

³¹⁶ Ibid.

³¹⁷ Ibid.

Shareholders may benefit from the remedy provided in section 163 of the new Act. This section allows a shareholder of a company to apply to court for relief, if the shareholder can prove that conduct by the company or its directors or officers has been oppressive or prejudicial to him or unfairly disregards the shareholders interests. This is a more useful remedy than the court review procedure under section 115. This remedy can be used by any shareholder, not just those who voted against the merger resolution³¹⁸. Also this remedy is broader and allows for more grounds for the court to intervene whilst the court review procedure allows a court to set aside a merger resolution on the basis of manifest unfairness or material procedural irregularity.³¹⁹ The court has a wide range of remedial powers which include setting aside a transaction and the awarding of compensation to a shareholder, but we will have to wait to and see how this remedy will interact with the court review procedure under section 115 as there seems to be no apparent good reason as to why a shareholder would not want to avail himself of the remedy in section 163 or in conjunction or as an alternative to the review procedure set out in section 115.³²⁰

Cassim argues that a shareholder 'may not be able to get the resolution or transaction set aside under s 163, because s 115(7) says the court may only set aside the resolution on the grounds set out in that section'.³²¹ However, Davids is of the opinion that 's 115(7) is better interpreted as applying only in the context of a review transaction initiated in terms of s 115(5) or (6) and we would argue that it cannot be read as limiting the court's remedial powers under s 163'.³²² The oppression remedy has a disadvantage in that it might become a costly and time-consuming process, unlike the section 115 procedure where the shareholder can if 'the resolution was opposed by at least 15% of the voting rights that were exercised on that resolution, and any person who voted against the resolution requires the company to seek court approval'³²³ and also make the company pay for costs, the shareholder in the oppression remedy will bear its own costs until a court makes a costs award in the

³¹⁸ Ibid.

³¹⁹ Section 115(7) of the new Act.

³²⁰ Davids, Norwitz & Yuill op cit note 10 at 362.

³²¹ Cassim op cit note 39 at 173.

³²² Davids, Norwitz & Yuill op cit note 10 at 362.

³²³ Section 115(3) of the new Act.

shareholders favour.³²⁴ This is a deterrent factor for using this remedy. If you can afford and are will to bear this risk, and then there is no reason not to apply this remedy.

7.2) Protection of creditors

Creditors of the merging companies require protection, because once the merger has been implemented, the creditors of each of the merged companies would effectively be in competition with one another.³²⁵ This is very 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’.³²⁶ In the context of mergers a key concern would be the protection of third party creditors of the merging company. These creditors may now find themselves with a new debtor and as such be involved with a new company who is less creditworthy than the previous company whom business was done with. This section of the chapter will discuss the mechanisms available in the new Act for the protection of creditors. The term ‘creditor’ is not defined in the act and therefore it is unclear whether it would apply only to financial creditors or if interpreted more broadly to include ‘all contractual counterparties or even creditors who may not have formal contracts with the merging companies such as employees and delict victims’.³²⁷ This will be clarified, hopefully, in time by the courts or by regulation.

7.2.1) Mechanisms for Creditor Protection

One of the mechanisms used for the protection of shareholders is the solvency and liquidity test mentioned above. In terms of section 113(1) with reference to section 4 of the new Act, before preceding with a merger the board of each of the amalgamating or merging company is required to have a reasonable belief that ‘upon

³²⁴ Section 163 of the new Act

³²⁵ Cassim op cit note 19 at 13.

³²⁶ Cassim op cit note 19 at 13 and s 223 of the New Zealand Companies Act, 1993.

³²⁷ Davids, Norwitz & Yuill op cit note 10 at 364.

implementation of the amalgamation or merger, each amalgamated or merged company will satisfy the solvency and liquidity test'. This test simply requires that at a given date, with all foreseeable financial circumstances taken into account, that the assets must exceed liabilities and that the company will be able to pay to pay off its debts in the next 12 months within the ordinary course of business once the merger or amalgamation has been implemented.³²⁸ This should provide some form of comfort to the creditor, although it is a very short term form of comfort. Under section 116(1)(a) of the new Act, before the merger or amalgamation can be implemented, a written notice must be delivered to all known creditors and the creditors then have 15 business days to ask for a court review of the transaction. The court will only, under section 116(1) (c), grant leave only if it satisfied that 'the applicant for leave is acting in good faith; if implemented, the amalgamation or merger would materially prejudice the creditor; and there are no other remedies available to the creditor'. Courts would have to consider what is meant by 'material prejudice'. Davids gives an example of this and states: 'to a creditor to argue that a debtor who, albeit solvent and liquid for the immediate future, is significantly less creditworthy than the party with whom it originally contracted (because it is now competing with other creditors of the merged entity who have proportionately greater claims)?'³²⁹ This is very vague, but the courts will in over the coming years clarify whether this is intended and 'refer to material prejudice relative to the creditor's contractual rights rather than introducing a fiduciary overlay to what is essentially in most cases a contractual relationship'.³³⁰

The additional creditor notification requirement and waiting period 'will add a significant element of risk and substantial delay to any transaction structured as a merger and could largely undermine the utility of the new procedure'.³³¹ It is unclear why this extra procedure is needed as the board would have completed the solvency and liquidity assessment and in most cases the important creditors are protected by contract and other creditors like the taxman and employees will have protection

³²⁸ Section 4(1) of the new Act.

³²⁹ Davids, Norwitz & Yuill op cit note 10 at 365.

³³⁰ Ibid.

³³¹ Ibid.

under the relevant tax and labour legislation.³³² The protective measures in the new Act appear to be ‘motivated by an inherent suspicion of transactional activity and fear of upsetting the status quo’.³³³ M & A regulation is aimed at protecting the ‘rights and legitimate expectations’ of all the stakeholders and these are normally protected by contractual relationships, as such the law should seek not to balance the scales in favour of protectionism as this might stifle ‘value-adding economic transactions’.³³⁴ This additional notification and waiting process is a step too far.

Small trade creditors are afforded protection by the use of the solvency and liquidity test as many of them would not have contractual protections in place³³⁵. Another, depending on the company, class of potential creditors is delict victims and for those companies usually involved in activities that give rise to delictual liability will in most cases have an all inclusive insurance in place which will then be transferred to the new merged entity.³³⁶ All potential delictual claims have to be accounted for by the board of a merging company in its solvency and liquidity assessment.³³⁷ This remedy is only available in limited circumstances in practice. The requirement of ‘material prejudice’ has set the bar alarmingly high and in many cases a creditor would have other remedies available to him, either contractual or statutory, which would then not entitle the creditor to any relief.³³⁸ There seems to be no clear obligation on the part of the merging companies to ‘to disclose the content of the merger agreements in so far as it relates to creditors, and they may well therefore have to use a court application to lay their hands on that agreement’.³³⁹ As a listed company, the JSE may require the documentation to be available for inspection under its rules.³⁴⁰

The requirement that every known creditor of the company must be given notice of the merger seems to be unnecessary. Cassim suggests that it would be more viable to

³³² Ibid.

³³³ Ibid.

³³⁴ Davids, Norwitz & Yuill op cit note 10 at 365.

³³⁵ Ibid.

³³⁶ Ibid.

³³⁷ Ibid.

³³⁸ Davids, Norwitz & Yuill op cit note 10 at 366.

³³⁹ Ibid.

³⁴⁰ Ibid.

‘impose some kind of materiality threshold’ like the in Canada and New Zealand.³⁴¹ Another way to look at this would be to follow the constructive notice procedure like that under section 34 of the Insolvency Act 24 of 1936, is implemented by the publishing of the a notice of sale of a business in the *Government Gazette* and certain newspapers that circulate within that area. Although this is more practical, it has the effect that it will weaken a creditors’ ability to enforce their rights especially with regard to the limited time that they have to do so.³⁴²

Section 116(7) states:

‘When an amalgamation or merger agreement has been implemented... (b) each newly amalgamated, or surviving merged, company is liable for all of the obligations of every amalgamating or merging company subject to subsection (8), the requirements of section 113(1), and any provision of the merger agreement, or any other agreement’.

Section 116(7) (b) provides that the surviving or new entity will automatically assume all the obligations of each of the merging companies. This seems to imply that if there is going to be more than one surviving merged entity, then each ‘will be liable for all for the liabilities of each of the merging entities’.³⁴³ This section goes further by stating *inter alia* to ‘the requirements of section 113(1), and any provision of the merger agreement, or any other agreement’. It is unclear what is meant by this. Section 113(1) provides that ‘two or more profit companies, including holding and subsidiary companies, may amalgamate or merge if, upon implementation of the amalgamation or merger, each amalgamated or merged company will satisfy the solvency and liquidity test’.

The reference made to 113(1), in the mind of the legislators, is to re-emphasis this requirement, to the extent ‘that the allocation of liabilities in the manner provided for in the first part of s 116(7)(b) will result in the merged entity/ies not satisfying the solvency and liquidity test, the merger may not be implemented or whether it is intended to imply that the merging parties are able, by agreement, to the extent that there is more than one merged entity, to allocate the liabilities in such a way as to

³⁴¹ Cassim op cit note 19 at 14–15.

³⁴² Davids, Norwitz & Yuill op cit note 10 at 366.

³⁴³ Ibid.

ensure that each of the merged entities satisfies the test'.³⁴⁴ Under section 116(7)(b) liabilities are allocated and are made subject to the merger agreement. This would support the latter interpretation above. This also appears to imply that parties are free to agree that they will not follow the principle in the first part of section 116(7)(b), but agree that they will allocate the liabilities of the merging entities in a manner they deem fit, provided that upon implementation, each entity would have had to have satisfied the solvency and liquidity test.³⁴⁵

It is presumed that in making the 'liability of the merged entities for the merging entities' obligations subject to the merger agreement', section 116(7) (b) does not at all state that the merging parties can agree that specific liabilities shall not be transferred to the merged entities at all.³⁴⁶ A rereading of the definition of an 'amalgamation or merger' will establish that all liabilities have to be transferred and those entities that are not intended to survive the merger are automatically dissolved when the merger is implemented, which means that it is impossible that liabilities should be left behind.³⁴⁷ In terms of section 116(7)(b), the 'automatic assumption of liabilities by the merged entity or entities, is also made subject to the provisions of 'any other agreement', which presumably means only that the assumption of obligations by the merged entity/ies will take place only to the extent that any agreement between the merging party and its creditor does not terminate in the event of a merger taking place'.³⁴⁸ Creditors can therefore protect themselves by contract so as to avoid being subjected to the results of the merger. Creditors on the whole in the new Act, seem to be given reasonable protection, but many will want added protection and will seek to have contracts established, which means that they would have contractual remedies available to them if a merger takes place. These safeguards are comparable to that of the mechanisms used in Canada and New

³⁴⁴ Davids, Norwitz & Yuill op cit note 10 at 366-367.

³⁴⁵ Davids, Norwitz & Yuill op cit note 10 at 367.

³⁴⁶ Ibid.

³⁴⁷ Ibid.

³⁴⁸ Ibid.

Zealand. However one distinct difference is that not all creditors in those jurisdictions receive written notice of the merger.³⁴⁹

³⁴⁹ 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. See Cassim op cit note 19 at 15.

CHAPTER 8-

Conclusion

8) Conclusion- My opinion of the provisions for amalgamation and mergers in the new Act

M&A in the future will be much easier to accomplish and as a direct result will be suited to South Africa's growing economy. The legislature has created a more 'efficient, flexible and potentially less expensive legislative M&A environment'.³⁵⁰ The real test will be once the new Act is implemented. The aim of the new Act is promote merger activity and at the same time avoid making stricter and sophisticated regulatory requirements, thus empowering a wider range of South Africans. Through the discussions that have ensued during the paper, I have tried to highlight most of the resultant factors should the new Act be implemented on time, although very unlikely at this time. If in all eventualities the new Act is implemented on time, a vast amount of materials will appear from practitioners critiquing the provisions and providing suitable solutions to any unforeseen situations.

Companies would normally present to the board and its shareholders with distinct advantages of the proposed merger and at the same time pay less attention to the disadvantages should the merger be implemented. Advantages of a merger can include but not limited to acquiring a large market share; the entering of new markets (national and international); the elimination of competitors; to allow a company to acquire expertise or assets; transference of skills; saving of costs; increase efficiencies or capitalize on synergies and one of the main reasons why companies enter into such transactions is that they can now consolidate their power and control over markets and government.³⁵¹ These advantages of such should be placed in the agreement as some form of goals to be achieved by the merger, a preamble of sort.

³⁵⁰ Cron op cit note 178 at 16.

³⁵¹ 'Mergers and Acquisitions- RA Newsletters' available at <http://retranchmentassist.co.za/index.php/ra-newsletters/110-mergers-and-acquisitions>, accessed on 6 September 2010.

The introduction of the *solvency and liquidity test* will prove to be a protective measure, although it may take longer to implement the merger the result is that the companies involved will have clear picture of the company's current and future financial position. This test not only applies to fundamental transactions but to other aspects in the new Act including distributions. The introduction of the test is seen as a welcomed innovation as no merger or amalgamation can take place without passing of the test. It is a safeguard for creditors and shareholders.

Mergers within certain thresholds³⁵² still have to be notified to the Competition Commission. The new Act could and still can provide a method where the Companies Commission and Competition Commission are notified simultaneously. This decreases the burden on the Companies involved, as this can save time and money in the filing process. Merger control³⁵³ is still important. The Competition Commission still plays a vital role in mergers, but I do believe a common medium needs to be found between the two.

The provisions governing amalgamations and mergers have been subject to a fair amount of criticism as they may give rise to much uncertainty, however practitioners have explained that this innovation was much needed and should be viewed as a much needed step to reforming South Africa's corporate law so that it is in line with

³⁵² Competition Act 89 of 1998 section 13. 'The Competition Commission must be notified of all intermediate mergers and acquisitions if the value of the proposed merger equals or exceeds R560 million (calculated by either combining the annual turnover of both firms or their assets), and the annual turnover or asset value of the transferred/target firm is at least R80 million. If the combined annual turnover or assets of both the acquiring and transferred / target firms are valued at or above R6.6 billion, and the annual turnover or asset value of the transferred / target firm is at least R190 million, the merger must be notified to the Competition Commission as a large merger. If the proposed transaction does not meet criteria of intermediate or large mergers it will be categorized as 'small merger.' Section 13(2) of the Act allows for voluntary notification of small mergers by the parties at any time. Section 13(3) of the Act further determines that the Commission may require the parties to a small merger to notify the merger to the Commission within 6 months after implementation'.

'Merger Thresholds' available at <http://www.compcom.co.za/merger-thresholds/>, accessed on 19 January 2011.

³⁵³ In *Distillers Corporation (SA) Ltd and Another v Bulmer (SA) (Pty) Ltd and Another* (unreported case no 08/CAC/MAY01; 27-11-2001) the Competition appeal court stated that: '... [M]erger control ... allow[s] the relevant competition authorities to examine a wide range of transactions which could result in an alteration of market structure and in particular reduce the level of competition in the relevant market.'

modern trends in foreign jurisdictions.³⁵⁴ South Africa is now on path to harmonise its law with that of American Law, and as such departs from the traditional English Company Law.³⁵⁵ One must proceed with caution when implementing and deciding the terms of the amalgamation or merger. As with any new concept there are bound to be problems like the tax treatment of these types of transactions; the transactions challenged by dissatisfied shareholders using the appraisal remedy and the uncertainty of how the courts will react to these transactions as no precedents exist. The only form of comfort that a company or shareholder may have is the fact that these principles are well established in other jurisdictions, but it is not guaranteed that since that type of transaction worked in another country that it will work in South Africa or have the same level of effectiveness.³⁵⁶ Practitioners must point out to their clients all risks with regard to the specific transaction.

It is my view that the provisions in the new Act will improve and stimulate merger activity in South Africa. Although there seems to be many provisions that discourage such activity the underlining feature of the Act is make procedures available to all those involved in the transaction which includes protective measures for persons who may face a substantial financial loss. The procedures may seem time consuming but as the courts learn to deal with the new matters before them the process will eventually speed up and become a smooth run procedure. This means that judges need to be accustomed with the new law and processes. Shareholders now have many remedies available to them unlike the previous act where more protection was afforded to the companies.

The introduction of section 164 is a cause for concern not only because it is a new concept in our law, but that it could inhibit corporate activity. If a company is planning a transaction(s) it would need to consider whether minority shareholders will exercise their appraisal rights. This is very difficult to do especially at the onset of the transaction because the company would then have to incur further costs so as

³⁵⁴ Sidney Pretorius. 'Introducing a new instrument for mergers and amalgamations'. *Without Prejudice*, Vol 10, Issue 5, Jun e 2010. Pg28-30.

³⁵⁵ Cassim op cit note 5 at 42.

³⁵⁶ Pretorius op cit note 353 at 29.

to buy those minority shareholders out. Companies would need to create a separate budget in case such a situation arises.³⁵⁷ Directors of the merging or amalgamating companies must disclose if there is a conflict or potential conflict of interest to any of the transactions in chapter 5. Shareholders are thus provided with the necessary information that the Director or Directors are not part of the transaction solely for their gains but have the company's goals as a priority.

One of the improved features in the new Act is employee rights. They now have available to them ways in which to place a transaction on hold. Employees are therefore afforded more protection, even if they are not shareholders. Mergers could result in the loss of skilled employees, which would mean greater cost to the company to try and fill those vacancies. Companies need to look at whether productivity will increase. Companies must ensure that employment terms, conditions and benefits are proper because if a company rushes into a merger and employee rights are infringed, they could face heavy law suits and class actions as employees and trade unions are given greater rights than before. One must keep in mind that during a merger, employees are the first victims of retrenchments and changed working environments. Employers must be careful when conducting a merger with regard to employees. Carl Stein of *Bowman Gilfillan* has the same viewpoint and states that 'it is a possibility that the unions that objected to the unbundling of shares by telecommunications provider Telkom in cellular network provider Vodacom in about 2009, and took them to court on a number of occasions without success, could have been successful in stopping the deal or possibly postponing it for a considerable time, if the new Act had been law at that time...'.³⁵⁸

Transactions will now not be as simple to implement as before because of the interests held by other stakeholders. The new Act also allows for electronic

³⁵⁷ Stephen Kennedy-Good. 'Effect of new Companies Act 2008 on Mergers and Acquisitions'. Finweek. August 12, 2010. Available at http://www.deneysreitz.co.za/index.php/news/effect_of_new_companies_act_2008_on_mergers_and_acquisitions/, accessed on the 6 September 2010.

³⁵⁸ Tracy Hancock. 'New law may lead to increasing class-action lawsuits' available at <http://www.polity.org.za/article/new-law-increase-in-class-action-lawsuits-2010-04-02>, accessed on 9 April 2010.

communication which means that cross border mergers are easier, cost saving and less time consuming with regard to the printing and signing of documents as electronic signatures and copies are now permitted in the new Act.

Another important conclusion should have been the separation of the definitions of a merger or amalgamation. It is unclear why the drafter would choose to leave it out in the final draft of the new Act. This would have definitely provided more clarity on each of the terms. If they wished not to include it in chapter 1, they should have at least considered placing it within chapter 5 rather than omitting them completely. The new Act has achieved its goal of creating a simpler procedure for M&A transactions as well as for those companies wanting to amalgamate. Although the new Act has a simple procedure the process is time consuming. Ultimately, choosing the appropriate procedure will depend on the circumstances of the company. However, the statutory merger procedure offers great flexibility and is a more attractive option than the other fundamental transactions offered in the new Act. It is in my opinion that the current environment for mergers has become more situated to South Africa's growing economic situation. Mergers activity is not overregulated and as a result more mergers will be concluded. The provisions introduced into our law are an important addition to the economic and business environment. The new statutory merger and the provisions within chapter 5 are a great addition to South African Company Law.

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