

APPRAISAL RIGHT AND FAIR VALUE DETERMINATION UNDER THE
COMPANIES ACT NO 71 2008: A CRITICAL ANALYSIS.

BY

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DEDICATION

This thesis is dedicated to Almighty God and my wonderful parent: Prof. and Chief (Mrs) Olaofe.

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CHAPTER ONE

INTRODUCTION

1.1 Background

In South Africa, the Companies Act¹ makes it the duty of the board of directors to see to the day to day activities of the company.² The board sees to the policy making of the company and its implementation. Notably, the composition of the board is by appointment based on shareholders vote. The shareholder with the majority vote elects his vote to appoint directors of his choice. In other words, the majority shareholder controls the company.³ In situations requiring shareholders vote, the majority shareholder uses his shares, which is his own propriety right, to his own advantage and votes in favour of his position on such issues. This position sometimes affects the minority shareholder.⁴ This brings to question the necessity for the protection of the minority shareholder.

There are various remedies under the South African's Companies Act for the protection of the minority shareholders who feel their interests in the company are threatened by the decision of the board or the majority shareholder. These remedies include the derivative action,⁵ relief from oppressive and unfairly prejudicial conduct,⁶ application to declare a director delinquent⁷ and appraisal right.⁸ They are provided to protect minority shareholders from oppression. This thesis examines the appraisal right of dissenting shareholders.

¹ No 71, 2008. In this work, the Act referred to is the 2008 Act except where specified.

² Section 66(1) 2008 Act

³ Alan Dignam *Hicks and Goo's Cases and Materials on Company Law* Seventh Edition Oxford University Press 2011 p 424

⁴ Andrew Hicks and S.H Goo *Cases and Materials on Company Law* Fourth Edition Blackstone Press Limited 2001, p 222

⁵ Section 165

⁶ Section 163

⁷ Section 162

⁸ Section 164

Appraisal right is a remedy that allows dissenting shareholders to opt out of the membership of a company⁹. The remedy enables the minority shareholder to exit the company when in disagreement with the resolution of the company to either alter the company's memorandum as regards class of shares¹⁰ which adversely affects the right and interest of the shareholder or enter into a major transaction¹¹, as is detrimental to his interest in the company. For instance where the company resolves to amend its memorandum with reference to voting right of a particular class of shares, as this would ultimately affect the level of influence of the particular shareholder while voting in shareholders meeting. Thus, appraisal right is an exit mechanism for a shareholder who feels that actions or decisions of the company alter its interest in the company.¹² The remedy is otherwise called dissenters right, share purchase remedy, minority buy-out or buy-back.¹³

The appraisal right is triggered by the company's notice given to shareholders for a resolution to embark on a major transaction or to alter classes of shares.¹⁴ In the absence of a notice, the right is triggered when the shareholder becomes aware of the resolution, as adopted by the company.¹⁵ Upon the notice of adoption of the resolution made at the meeting, the shareholder hands in a written demand to the company to purchase his shares.¹⁶ Upon fulfilling the necessary requirement,¹⁷ the company must make an offer to the shareholder in respect of the shares in question. The board is mandated to evaluate the value of the shares involved and make an

⁹ Farouk HI Cassim 'et al" *Contemporary Company Law* Second Edition Juta Ltd 2012 pg 796

¹⁰ S 164(2) (a)

¹¹ S 164(2) (b). These transactions as spelt out in S112, 113 and 114 are disposal of all or greater parts of assets or undertaking; Amalgamation or Merger; Scheme of arrangement. These are referred to as fundamental transactions.

¹² Farouk HI Cassim 'et al" *Contemporary Company Law* Second Edition Juta Ltd 2012 pg 796

¹³ Farouk HI Cassim 'et al" *Contemporary Company Law* Second Edition Juta Ltd 2012 pg 796

¹⁴ Section 164(2)

¹⁵ S 164(6)

¹⁶ Section 164(5)

¹⁷ This is discussed in extensively in chapter 3

offer to the dissenting shareholder.¹⁸ The offer made must be seen as fair. The director must also accompany the offer with a written statement to show how the value was arrived at.¹⁹ This is necessary to show the shareholder how the value offered was determined. The offer made must be determined as at the time immediately before the resolution was taken.²⁰ The disagreement of the parties is often based on this attached statement as the parties often fail to agree on the matters considered by the company in arriving at the value. In the instance of a disagreement to the fair value, an application can be made by the shareholder to the court for determination of the fair value of the shares.²¹ The ground for the application is the inadequacy of the offer.²² The disagreement necessitates the introduction of the court. The court, in hearing the application, is saddled with the objective of determining the fair value of the shares as at the time the transaction was adopted. The introduction of the court in the remedy would have been avoided if the Act had explicitly stated the procedure, manner or method to be adopted to determine the value. The dissenting shareholder would have been able to determine the actual value and envisage his likelihood of success in approaching the court.

1.2 Objective

Based on the problems leading to the remedy, the appraisal right comes in handy. One of the key attributes of the appraisal right is the determination of the fair value of the shares in the company. The company, in making an offer to purchase the shareholder's share, must determine the value of the shares as held by the shareholder. This must be determined as at the time before the event that led to the remedy was adopted.²³ The means of determining the fair value of the shares is central to the remedy. This enables the company to make a fair offer to the dissenting shareholder. It also aids the court in arriving at a fair value of the shares.

¹⁸ Section 164(11)

¹⁹ Section 164(11)

²⁰ Section 164(16)

²¹ Section 164(14)

²² Section 164(14)(b)

²³ Section 164(16)

Regrettably, the Act does not make provision for the manner in which the value of the shares is to be determined. It simply states that the value must “be determined as at the date which, and time immediately before” the company adopted the resolution.²⁴ This thesis examines the appraisal right remedy, its efficacy and aims at identifying the various methods of determining the fair value of shares in the company and the best method or manner of doing so.

1.3 Methodology

In carrying out this objective, a legal comparative and critical approach of study would be adopted. A comparative analysis of the remedy in Delaware Jurisdiction would be examined to show how the jurisdiction determines fair value of shares.

In evaluating the topic and addressing the questions posed, recourse is had to the following sources of law: South African Companies Act²⁵, The Model Business Corporation Act²⁶, the Delaware General Corporation Law, and opinions of experts, practitioners and academics, as expressed in journals, notes and textbooks.

1.4 Outline

This first chapter, as observed, provides the background to the thesis.

The second chapter outlines the minority shareholder protection under the Old Act prior to the introduction of the appraisal remedy. The remedy available to the minority shareholder before the coming to force of the appraisal right is examined to see the inadequacy of the remedies, which necessitated the new remedy. The basic innovations in the new Act, on the remedies are highlighted.

Chapter three examines the Appraisal remedy, outlining the procedure. The chapter further assess whether the remedy has successfully rescued the minority from the grabs of the majority.

In chapter four a comparative study of the remedy is carried out in relation to the Delaware Jurisdiction in the United States. An analysis of the jurisdiction would

²⁴ Section 164(16)

²⁵ The 1973 and 2008 Act

²⁶ The 2002 Act

benefit the thesis as it portrays areas where the practice can be of benefit to the South African corporate world.

Chapter five examines how the fair value of the shares is determined. The chapter identifies methods used in the Delaware Jurisdiction to resolve the fair value issue.

The thesis ends with chapter six on conclusion and recommendation on how the remedy as practised in Delaware Jurisdiction, would be of benefit to the South African Jurisdiction, especially with reference to instituting an application in court and determining the fair value of shares.

University of Cape Town

CHAPTER TWO

POSITION PRIOR TO APPRAISAL RIGHT REMEDY

2.1 Introduction

In this chapter the position prior to the introduction of the appraisal right remedy is examined in order to highlight the significance of the appraisal right remedy.

In the corporate realm, the affairs and running of the company are presided over by the board of directors. The board is saddled with the responsibility of seeing to the activities of the company.²⁷ However actions of the company, as regards major fundamental transactions,²⁸ are sanctioned by the votes or decisions of the shareholders.²⁹ Naturally, the shareholder with the highest number of shares controls the company through its vote. This is the majority shareholder.³⁰ The use of the vote is to the advantage of the majority and in some instances to the detriment of the minority shareholder. The shares occupied by the majority shareholder are his proprietary right and he employs it in ways best suitable to him.³¹

2.2 Minority Protection

The board of directors in running the company is saddled with the responsibility of instituting legal proceedings in the name or on behalf of the company to address wrongs against the company. The board by its actions protects the interest and investment of shareholders in the best interest of the company.³² In corporate practise, the board is mainly constituted by the majority shareholder or its representative. The majority shareholder mostly determines who is on the board. The board, being mindful of the majority shareholders, could either omit or perform an act depending on the suitability to the course of the majority. In most instances,

²⁷ Section 66(1) of the Companies Act 2008

²⁸ This is as titled in the 2008 Act: Chapter 5.

²⁹ Section 115

³⁰ Technically, the majority shareholder has 51% or more of the voting shares on the company. But in certain instances, the majority shareholder might have below 50%, but with the minority votes in clusters. E.g. the majority shareholder might have a percentage of 30%, with others 15%, 10%, 12%, 18% and 15%.

³¹ Andrew Hicks supra 222

³² Section 76

such actions are to the detriment of the minority shareholder. The main wrongdoers or beneficiary of the wrong, in most situations, is actually the majority shareholder. This is the reason why action is not taken to correct the wrong done. At times, where permitted, the action is ratified by the board or the shareholders.

In the same vein, when the shareholders' votes are needed to sanction a transaction or act of the board³³, the majority shareholder votes in favour of its stand. This stand may in actual fact be against the norm or interest of the company or the minority shareholder.³⁴ Sometimes, the majority shareholder would omit to perform some acts in favour of the company which could, in effect, affect the company or minority shareholder negatively.

In instances where the specified wrong is done by the majority against the company or cases where the majority has benefitted from the transaction, the majority might omit to pursue the matter and seek redress in court or simply ratify same where permitted. This is further buttressed by the corporate rule of instituting litigation on behalf of the company. In corporate litigation, the "proper plaintiff" in a matter before the court is the company itself. Any wrong against the company can only be addressed by the company³⁵. This principle was well pronounced in the case of *Foss V Harbottle*³⁶ where it was affirmed that the company and not its shareholders can bring an action against the wrongs done to the company. This in effect is to protect the company from unwanted and harmful litigations. Nevertheless, as an exception to the *Foss V Harbottle* rule, a minority shareholder can institute an action in court where it involves violation of a personal right as guaranteed under the constitution of the Company or it is a fraud against the minority.³⁷ However, this decision has been overtaken by statute. The Companies Act³⁸ now permits the shareholder, director,

³³ In instances where the shareholders vote is needed to ratify an act or transaction.

³⁴ For instance, where the Board or a Director has defrauded the company or acted ultravires and benefited from the deal

³⁵ Buttressed by Lord Davey in *Burland V Earle* [1902]A.C 83 at 93 (P

³⁶ (1843)2 hare 461; 67 ER 189

³⁷ H.S Cilliers "et al" *Corporate Law* Second Edition, Butterworths 1992 p 290

³⁸ 2008 Act

prescribed officer, registered trade union to bring an action on behalf of the company.³⁹

Consequently, the minority is left bare and without protection from the board, as supported by the majority. This has stirred the need for the protection of the minority from acts detrimental to their interest and investment in the company. Protection of minority shareholders is salient as to guarantee their interest in the company, as controlled by the majority shareholders through the board.

Naturally, upon oppression by the majority, the minority shareholder might consider leaving the company. But the idea of selling their shares is encumbered as the article of the company, in most cases, restricts the transfer of shares. This would only be made possible by the approval of the board or other shareholders. And at times, the majority shareholder or existing shareholders is given the option of “first refusal”⁴⁰ on the shares. Also, the absence of a ready-made market for the shares sale makes it difficult for the minority shareholder to dispose the shares, unlike listed companies’ shares. Being a minority shareholder in a company is not an enviable position as it does not come with “having a say” in the affairs of the company.

The introduction of the appraisal remedy is thus a welcome development as it allows the minority to exit with his cash.

2.3 Protection under the Act

Before the introduction of the appraisal remedy, the means of protection for minority shareholders were the derivative action,⁴¹ the common law derivative action and relief from oppressive and unfairly prejudicial conduct.⁴² These are also guaranteed under the new Companies Act of 2008, with some innovations. A brief description provided by the new Act follows.

³⁹ Section 165(2)

⁴⁰ This simply means the shareholder is given the option to first accept or refuse the shares. It is only when the shareholder has refused the shares that the minority shareholder can sell to the outside world.

⁴¹ Section 266 of the 1973 Act

⁴² Section 252 of the 1973 Act

(a) Derivative Action

A derivative action is brought by a person on behalf of the company to protect the legal interest of the company or assert the right of the company.⁴³ Such right is embedded in the right of the company to bring such an action. As a norm, the board is saddled with the authority to institute legal proceedings on behalf of the company. Consequently, upon the failure of the board to proceed with an action, the shareholder can activate the derivative action to institute such action on behalf or in the name of the company. An example of such an action would lie where the company has been defrauded by its own Directors, who incidentally are the majority shareholders, and have used such positions to enrich themselves. The minority shareholder can set in and seek redress on behalf of the company. This is only when the board has failed to bring the action. The reason for such an action being that the board, controlled by the majority shareholders, had used their position and power to prevent the company from bringing an action to redress the wrong. This is an exception to the rule laid down in *Foss V Harbottle*.⁴⁴

Under the 1973 Act, the action could be instituted by a member where the company has suffered damages or loss or has been deprived of any benefit. This could be as a result of a wrong done to it or a breach in trust by the director or officer of the company.⁴⁵ It is duly noted that such actions would not have been ratified⁴⁶ and not acted upon by the company⁴⁷.

The remedy serves as a shield to the minority shareholder by protecting his interest. The minority shareholder avails himself of the remedy to assert the right of the company which has come to his knowledge and left unattended to by the management. In such instances where the majority or the controller of the company has refused to act, the minority can step in with leave of the court to act on behalf of the company.

⁴³ Farouk HI Cassim " et al" *Contemporary Company Law*, 2nd Edition Juta Ltd 2012 at 775

⁴⁴ Supra

⁴⁵ Section 266 of the 1973 Act

⁴⁶ The act must be an unratifiable act

⁴⁷ See Cilliers H. S., "et al" *Corporate Law* 3rd edition Butterworth 2000 at 300.

The full application and compliance with the doctrine of *Foss V Harbottle* would amount to undue harshness and unjust repercussion on the minority, and in the long run, the company. Directors of the company could use their position in the company as means to enrich themselves by virtue of information available to them, thereby acting against the best interest of the company.

As an improvement, the new Act⁴⁸ has made some salient additions to the derivative action. The new Act has broadened the scope of the derivative action remedy. The new derivative action has abolished the common law derivative action⁴⁹, the rule in *Foss V Harbottle*, and replaces it with a statutory derivative action in section 165. Likewise, the new derivative action now allows a shareholder⁵⁰, director or prescribed officer⁵¹, a registered trade union representing the employees or another employee representative⁵² or any other person with the leave of the court to institute an action to protect the interest of the company. The leave would only be granted where the court holds the view that such action is necessary as to protect the legal interest of the company as claimed by the applicant.⁵³ Also, the action, as against under the old Act, is now less cumbersome and less financially burdened. The applicant only need make the demand on the company⁵⁴ and the company takes the necessary steps to redress the damage by appointing an independent person to look into the matter and report to the board.⁵⁵ Only on the rejection of the application can the applicant apply to court for enforceability of the action.⁵⁶ However, the applicant can bypass the demand on the company if affirmed that the damage would be

⁴⁸ 2008 Act

⁴⁹ Section 165(1) of the 2008 Act

⁵⁰ Section 165(2)(a)

⁵¹ Section 165(2)(b)

⁵² Section 165(2)(c)

⁵³ Section 165(2)(d)

⁵⁴ Section 165(2)

⁵⁵ Section 165(4)

⁵⁶ Section 165(5)

irreparable or would result in substantial prejudice to the shareholder if time is delayed in bringing the application.⁵⁷

(b) Oppression and unfair prejudicial conduct

A minority shareholder could also be protected from the majority shareholder by seeking relief from oppressive and unfairly prejudicial conduct.⁵⁸ Actions embarked upon by the majority through their decisions which gravely affect the interest of the minority shareholder are deemed oppressive. An act could be declared unfair to the minority where such action greatly affects his interest in the company.⁵⁹

In seeking relief, the applicant must be able not only to prove that there was an act or conduct by the majority shareholder or the directors, but that such act was oppressive, unfairly prejudicial to the applicant or unfairly regards his interest.⁶⁰ The applicant must establish a lack of fair dealing and unfairness. Such acts are easily noted in instances where the majority shareholders use their greater voting power in an unfair manner to prejudice or override the minority shareholder. Such act is also envisaged in areas where the majority shareholder uses its voting power to knowingly exclude the minority from the running of the business of the company.⁶¹

It is noted that not all actions of the majority or the director which goes against the minority would be adjudged to be oppressive or unfair in nature. A minority, upon joining a company, is held to succumb to the doctrine of majority rule. Hence, an action based on the premise that decisions are always going against him, or that he is always out-voted in elections or debate would not be tenable as being oppressive in nature. An honest vote by the majority, which side-lined the interest of the minority would not pass for oppression. Ordinarily, votes are counted based on allotted votes to the shares held. In no way would a minority shareholder beat a majority shareholder in an election within the company. This is a fundamental principle in

⁵⁷ Section 165(6)

⁵⁸ This was guaranteed under section 252 of the 1973 Act

⁵⁹ Bayly V Knowles 2010 (4) SA 548 (SCA)

⁶⁰ Farouk HI Cassim 'et al' *Contemporary Company Law* Second Edition Juta Ltd 2012 pg 757

⁶¹ *Barnard v Carl Greaves Brokers (Pty) Ltd* 2007 JDR 0047 (C) 2

majority rule. Thus not all acts that affects their interest or disregards same would be regarded as oppressive. The key element is being unfair in nature.

In the case of *Scottish Co-Operative Wholesale Society Ltd V Meyer*,⁶² the holding company, the plaintiff here, deliberately used its controlling power to deprive the subsidiary company from carrying on its business, which was the manufacturing of rayon. The intention of the holding company was to make sure that the business of the holding company gets transferred to one of its department. This act of the holding company led to a breakdown of business of the subsidiary and dwindles in shares. An action was laid and relief was granted to the minority shareholders of the subsidiary company on the ground that the act of the holding company had effectively been acted out by their nominees on the board which was against the interest of the company.

Under the new Act, the frame for this relief has been expanded. A director can now seek relief under this remedy.⁶³ Also, conducts complained of or deemed unfair could now result from:

- act or omission of the company or related person
- conduct or carrying on of business of the company or related person in an oppressive manner
- the exercise of the powers of the director or prescribed officer of the company or person related to the company.⁶⁴

2.4 Appraisal Remedy

It is against this background that the appraisal remedy was introduced. The obvious feeling was that the previous remedies were not sufficient.

An appraisal right is a remedy available to a shareholder to opt out of the company upon the entering of the company into a fundamental transaction and the alteration of the memorandum of the company which affects his shares, which he ultimately

⁶² [1958] 2 All ER 66, [1959] AC 324, House of Lords

⁶³ Section 163(1) of 2008 Act

⁶⁴ Section 163(1) 2008 Act

does not agree with.⁶⁵ Also, it is seen as a right of a dissenting shareholder who does not approve of the fundamental transaction to have its shares bought out by the company in cash, at a price reflecting the fair value of the shares, which may be determined judicially.⁶⁶ It gives him the privilege to exit the company without necessarily going through the rigour of looking for a buyer for his shares or manoeuvring the restriction on transfer of shares. This is discussed in detail in the next chapter.

This is an innovative remedy in the South African corporate law. One of the hallmarks of the remedy is the little or no recourse to the court. This eases the process of the shareholder leaving the company. The delay and unnecessary process within the company, as well as the court practise is avoided under the remedy.

2.5 Need for new remedy?

This innovative remedy is available specifically where the company enters into a fundamental transaction or alteration of share rights. Other forms of remedy earlier stated only allow for reprieve on the side of the minority shareholder but does not give him, as of right, the opportunity to opt out of the company. The minority shareholder is still locked in the company with the same “oppressive” majority. This is not to say that the minority shareholder cannot exit the company using other remedies. Specifically, under relief from oppressive conduct, the minority shareholder can exit the company or demand for the winding up of the company, upon application to the court.⁶⁷ But the courts have been reluctant to grant such applications or wind up the company. The court often uses its discretion to make such an order, which is only available under relief from oppressive conduct. Interestingly, as against the norm under the old Act with other remedies, the codification of the appraisal remedy now entitles the shareholder to the order to leave the company as of right and not convenience or discretion. This is a welcome development under the 2008 Act.

⁶⁵ Farouk HI Cassim ‘et al’ *Contemporary Company Law* Second Edition Juta Ltd 2012 pg 796

⁶⁶ William t. Allen and Reiner Kraakman *Commentaries and Cases on the Law of Business organisation* (2003)

⁶⁷ 252(3) old Act

2.6 Conclusion

The remedies available to the minority shareholder before the advent of the appraisal right only serve as protection to the interest and investment of the shareholder. The major relief and difference between the other remedies and the appraisal right is the exit of the shareholders from the company as of right, as against it based on the discretion of the court. The appraisal remedy and its procedure are discussed in detail in the next chapter.

CHAPTER THREE

SECTION 164: DISSENTING SHAREHOLDER'S APPRAISAL RIGHT

3.1 Introduction

An appraisal right is a mechanism made available to a dissenting shareholder in a transaction where he makes a demand on the company to buy his shares at fair value and exit the company. It allows the shareholder, upon disagreeing with the resolution of the company, to exit the company with cash⁶⁸. This guides against a situation where the shareholder is locked in the company against his wish.⁶⁹ The Act makes provision for the remedy in Section 164. The appraisal remedy is mainly used as a shield against the majority. It is often referred to also as minority buy-out right.

It is important to note that the right is only peculiar to the happening of certain events⁷⁰. The right is only activated when the company takes steps and issues notice to enter into fundamental transactions or to amend its memorandum of incorporation so as to alter the preferences, rights, limitations or other terms associated with a particular class of share.⁷¹ The fundamental transactions are, as listed in Chapter 5 of the Act, disposal of all or greater part of assets or undertaking⁷², amalgamation or merger⁷³ and scheme of arrangement⁷⁴. Upon the notice of any of the events, the right for appraisal is triggered. In calling a meeting to make a resolution for such transaction, the Act mandates the company to notify the shareholder about the right. This must be accompanied by the notice of such meeting.⁷⁵

Basically, the objective of the remedy is to create an exit for the dissenting shareholder. It is noted that the existence of such resolution would either drastically

⁶⁸ Farouk HI Cassim 'et al' *Contemporary Company Law* Second Edition Juta Ltd 2012 796

⁶⁹ As evident in other remedies available to the minority shareholder, except in extreme cases.

⁷⁰ In other events, the minority can employ other remedies as discussed earlier in chapter 1

⁷¹ S 164 (2)

⁷² Section 112

⁷³ Section 113

⁷⁴ Section 114

⁷⁵ Section 164(2)

affect the structure of the company⁷⁶ or the rights accruing to the shareholder⁷⁷. The coming into force of the resolution would alter the nature of the company and the shareholder's investment in the company. The rights accruing to a shareholder could also be affected. This is definitely not as envisaged by the shareholder. The remedy gives the shareholder the right to exit having seen the company deviate from the reason⁷⁸ which made him invest into the company in the first instance or the cumbersome obligation or reduced right⁷⁹ on him. The remedy seems the best viable option in such circumstance.

Likewise, with the introduction of the remedy, majority shareholders as well as the company would be heedful in making decisions. Decisions to be made by the company would ultimately be weighed against the number of minorities willing to exercise the remedy. It would be fool-hardy to go ahead with a transaction when majority of the minority are willing to explore the remedy.⁸⁰ This would definitely drain the purse and financial capacity of the company. This to me is a check on the arbitrariness of power of the majority.

3.2 The triggering events

The appraisal right remedy is not applicable at all instances to the minority. The remedy is only available to the shareholder when the company is entering into a fundamental transaction or amending its Memorandum of Incorporation to alter the preferences and rights pertaining to a share.⁸¹ In the absence of these events, the appraisal right cannot be invoked. In an instance where the minority is being oppressed by the director or the majority and barred from carrying out his duty as a co-director, this remedy would not avail him, but he would rather seek a relief under section 163 of the Act.

⁷⁶ This happens in the event of merger, amalgamation or disposal of all or greater part of assets.

⁷⁷ This is in event of a scheme of arrangement or alteration of share rights.

⁷⁸ Objectives of the company

⁷⁹ Voting right or increased financial liability

⁸⁰ The company could still go ahead though considering that the company is financially capable. But this should sure raise a concern with the investors coming into the company.

⁸¹ S 164(2)

The events which trigger the appraisal remedy are:

a. Proposal to dispose of all or greater part of undertaking

This is a situation where the company considers it appropriate to relinquish its asset or part of its undertaking to another corporate entity or persons. The company relinquishes its right over the asset.⁸² The disposal must be in reference to the major part of the company's asset or business objective so as to fall under this heading. Hence, in an instance where a company purports to sell a part of its business which amounts to only 5% of its business, the remedy would not be available to the shareholder, under this heading.

Section 112 of the Act gives the position of the law as regards the company disposing its undertaking. The company must as a standard, notify the shareholders for a meeting to consider the resolution.⁸³ This must be accompanied by a written summary of the transaction to be approved and how it is going to be implemented.⁸⁴ The shareholder should also be made aware of the procedure and rights available to him, in light of disagreeing with the decision.⁸⁵ It is noted that the decision to dispose the property or undertaking can only be approved by a special resolution.⁸⁶

b. Merger or Amalgamation

This is 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 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

⁸² Definition by Online Business Dictionary

⁸³ S 112(3)

⁸⁴ S 112(3)(b)(i)

⁸⁵ S 112(3)(b)(ii)

⁸⁶ S 112(2)(a)

the assets and liabilities that were held by any of the amalgamating or merging companies immediately before the implementation of the agreement.⁸⁷

In such a process, the liabilities and assets of the companies involved are combined into one entity, which may be one of the companies involved in the transaction or a newly formed company in its entirety.⁸⁸

In forming a merger, the procedure as stated in Section 113 must be adhered to. In approving the transaction, shareholders' meeting must be called for that specific purpose. It is noted that a special resolution of the shareholders is a pre-requisite for a merger.⁸⁹ It is important to note that before the resolution can be implemented, the board must conduct the liquidity and solvency test⁹⁰ for the process and ascertain that it is viable and the company is financially stable to carry out the transaction.⁹¹

c. Scheme of Arrangement

This is an arrangement between the company and the holders of shares or security of the company or its creditors.⁹² In the instance, there is a re-organisation of the company and the shares or security in question. This could be done by means of consolidation of shares into different classes, division of shares into different classes, expropriation of securities from the holders, exchanging any of its securities for other securities, a re-acquisition by the company of its securities or a combination of the methods stated.⁹³

⁸⁷ Section 1

⁸⁸ Farouk HI Cassim "et al" *The Law of Business Structures* 1st Edition, JUTA Ltd 2012 pg. 380

⁸⁹ S 113(5)

⁹⁰ This is as stated in Section 4

⁹¹ S 113(4)

⁹² H.S Cilliers "et al" *Corporate Law* Second Edition Butterworths 1992 p 450

⁹³ S 114(1)

The board in proposing the arrangement must adhere to the procedure and mandates of S 114 of the Act. A special resolution of shareholders is also needed to approve this scheme.⁹⁴

d. Amending the memorandum of incorporation

The Memorandum of Incorporation of a company is the binding document, notably in this respect, between the company and each shareholder.⁹⁵ It states the rights and obligations of the shareholders. Any amendment of the memorandum so as to alter the preference or right accruing to a specific class of share will trigger the remedy.⁹⁶ The amendment of the memorandum must be approved by a special resolution.⁹⁷ But this may not be adhered to where the amendment is as a result of a court order.⁹⁸

3.3 How applicable is the remedy in Business Rescue proceeding?

Interestingly, it is noted that these triggering events are in one way or the other noticed in the happening of a business rescue. The triggering events are means by which a company can embark to preserve the company. Business rescue is the process of rehabilitating a financially distressed company. At this point of being financially distressed, the company is adjudged unable to meet its financial obligations as the need arises. The effect of the proceeding is to make sure that the company does not go into liquidation. But in the event that the company cannot be revived, the proceeding maximises the company's asset to bring greater result than it would have yielded if allowed to go into liquidation straight-away. In the rescue proceeding, the company's greater asset or business can be disposed-off so as to fend off a large amount of the expenses of the company. Also, a scheme of arrangement can be entered so as to re-organise the company with respect to its debt. Small or part of the company's business can be merged with a stronger firm to keep it alive.

⁹⁴ Section 115

⁹⁵ S 15(6)(a)

⁹⁶ This would only be available for the shareholders affected by such change.

⁹⁷ S 16(1)(c)

⁹⁸ S 16(4)(b)

However, the Act has made the appraisal remedy unavailable in the event of a business rescue.⁹⁹ It is reasoned that during the business rescue, which birth the events, the business rescue plan must be approved by the shareholders. It is the business rescue plan that proposes the sale and disposal of asset or business, as well as whether some classes of shares could be re-arranged as to cut off financial cost implications.¹⁰⁰ In essence, the action taken by the company is sanctioned by the shareholders involved so as to stabilise the company. Likewise, the applicability of the remedy in a business rescue process would be placing the shareholders over the creditors. This is definitely against the intent of the Act.

3.4 Appraisal procedure

The dissenting shareholder must diligently observe the procedures in respect of the remedy. A strict observance and perfection of the procedure entitles the dissenter to the remedy. It is humbly noted that the procedure starts with the company, who issues the notice to the shareholders for a meeting to pass a resolution on the transaction. The notice duly triggers the right. Next is the shareholder who takes necessary steps, upon getting notice or coming into knowledge of the transaction, to perfect his position. This ranges from giving the dissenting notice, voting against the resolution and placing a demand on the company which happens after the company must have passed the resolution. The company, based on the demand of the shareholder now makes a fair offer for his shares.

The appraisal right is a unique remedy as it is less court-involved. The court is sparingly involved. The procedure only involves the court when there is a disagreement as to the fair value of the shares or in instances where the company applies for variation in payment of the fair value.

a. Notice

The procedure is commenced by a notice of the triggering events¹⁰¹ given out to the shareholders. The Act makes it mandatory for the company to notify the shareholder of his right of appraisal when sending a notice of a meeting for a resolution on the

⁹⁹ Section 164(1)

¹⁰⁰ Section 152

¹⁰¹ As stated in S 164(2)

transaction.¹⁰² The shareholder, upon having notice of the proposed meeting, must give a written notice of objection on the proposed decision of the company. The notice of objection must be given before the date of the meeting¹⁰³. This is the first step by the dissenting shareholder in the process. This is a very salient step in the process. The construction of the directive makes it mandatory for a dissenter who wants to exercise this right to give such a notice before the meeting. With the words of the directive, it seems that a dissenter would be barred from the remedy if an objection notice is not given, and as a matter of relevance, before the meeting. In principle, the dissenting notice must be in writing. This is for the company to be able to know the numbers of dissenter and the financial implication of the remedy, if allowed. This is reasoned would enable the company to know his financial strength as to both pay the dissenters and implement the resolution or shelve its plan for the transaction due to financial constraint.

But this requirement would not exclude a dissenter from exercising this remedy in two circumstances. Firstly, where the company fails to give a notice of the meeting where the decision was taken.¹⁰⁴ This would invariably mean that the shareholder was not aware of the meeting and could not have objected to an unknown meeting or agenda. Secondly, the dissenter would not be barred from the remedy where the company failed in the instance to include in the notice for the meeting, the right of the shareholder to the appraisal right.¹⁰⁵ This would amount to the company violating the requirement of the Act which mandates the company to notify the shareholders of their right.

b. Meeting

The second step for the dissenter in activating the right is to be present at the meeting and actually vote against the resolution. It is immaterial that the notice of dissent showing disapproval for the transaction had been given and served on the company; the dissenter must actually cast his vote against the decision in the

¹⁰² S 164(2)

¹⁰³ S 164(3)

¹⁰⁴ Section 164(6)

¹⁰⁵ Ibid

meeting. Also of note is that it is not sufficient that the dissenter was silent or abstained from the voting process. The dissenter must actually partake of the process and vote against the resolution.¹⁰⁶ The non-participation of the dissenter, either in the meeting or voting process, might be construed as technically changing his stand from his notice of objection.

After the meeting where the resolution was passed,¹⁰⁷ the company is mandated to give notice of the adopted resolution within 10 business days, to each shareholder who gave notice of objection to the resolution.¹⁰⁸ This set of shareholders must not have withdrawn the notice of objection¹⁰⁹ or vote in support of the resolution.¹¹⁰ This further emphasised and buttressed the point that the dissenter must actually vote against the decision, as the dissenter would not fall within the category of persons entitled to the notice of adoption from the company. The dissenter may be construed as “technically” silent or withdrawing his objection.

c. Demand

The third step for the dissenter, after receiving the notice of adoption of resolution by the company, is to place a demand on the company for the fair value of his shares.¹¹¹ This is consequent only when the shareholder has perfected his stand up to that state. The dissenter must have given a written notice of objection to the transaction before the meeting¹¹² and notwithstanding; the company went ahead and adopted the resolution.¹¹³ Also, the dissenter must have cast his vote against the resolution¹¹⁴ and complied with the procedural requirements.¹¹⁵ It is noted that in the

¹⁰⁶ S 115(8)(b)

¹⁰⁷ This is in assumption that the resolution was adopted, as it would have received the “blessing” of the majority

¹⁰⁸ S164(4)(a)

¹⁰⁹ S 164(4)(b)(i)

¹¹⁰ S 164(4)(b)(ii)

¹¹¹ S 164(5)

¹¹² S 164(5)(a)(i)

¹¹³ S 164(5)(b)

¹¹⁴ S 164(5)(c)(i)

case where the resolution amends the company's Memorandum of Incorporation, the dissenter's shares must have been materially and adversely affected by such an amendment.¹¹⁶ This confirms that not all shareholders would be availed of the remedy. Any shareholder who seeks to activate the right must be within the class of shares affected by the resolution.

Subsequently, upon satisfaction of the requirement, the dissenter can then make a demand on the company. The demand must be in writing and given to the company within 20 business days after receiving the notice of adoption of resolution from the company.¹¹⁷ The demand must state the particulars of the shareholder¹¹⁸ and the shares¹¹⁹ which the shareholder seeks payment for¹²⁰ and the demand for the fair value of the shares.¹²¹ But in a situation where the dissenter did not get a notice of the meeting or adoption of the resolution, or the company defaults in sending one, the dissenter must give a written notice of demand to the company within 20 days of coming into knowledge of adoption of the resolution.¹²²

d. Relinquishment of Right

At this point in the procedure, the dissenter has successfully perfected his demand on the company and the company is now saddled with the responsibility to address the demand of the shareholder. It is noted that at this point the shareholder has relinquished all his rights over the shares in question. The only right left is to be paid the fair value of the shares in question.¹²³ Hence, the normal right of notices to meeting, attending meetings, voting rights, dividends cease to exist. But at this stage

¹¹⁵ S 164(5)(c)(ii)

¹¹⁶ S 164(5)(a)(ii)

¹¹⁷ S 164(7)(a)

¹¹⁸ S 164(8)(a) The name and address of the shareholder

¹¹⁹ The number and class of the shares

¹²⁰ S 164(8)(b)

¹²¹ S 164 (8)(c)

¹²² S164(7)(b)

¹²³ S 164 (9)

also, the shareholder could reconsider his stand, which could be as a result of compromise and revert to *status quo*. This could be done by withdrawing his demand on the company before an offer is made or allowing the offer made by the company to lapse.¹²⁴ Likewise, the shareholder would revert back to status quo when the company fails to make an offer and the shareholder withdraws the demand.¹²⁵ When any of these happens the shareholder is deemed to be back to status quo as a shareholder of the company and his rights restored.¹²⁶ Another instance in which the shareholder's stand and right would be restored is when the resolution that gave birth to the demand is revoked.¹²⁷ The rationale behind this is, since the reason for opting out of the company is removed, the remedy cannot be seen to be in action. The remedy has been overtaken by event.

e. Offer of fair value by the Company

Consequent upon the fulfilment of the "perfection" of procedure process by the shareholder, the company must within five business days¹²⁸ make a written offer to pay what the company consider to be the fair value of the share to the shareholder(s) who has made a demand on the company.¹²⁹ The fair value must be determined as at the time immediately before the resolution was adopted by the company¹³⁰, and not afterwards.¹³¹ The manner at which the directors arrived at the fair value must be made known to the shareholder in a statement accompanying the offer.¹³² It is duly noted that the offer made by the company to a class or series of

¹²⁴ S 164(9)(a)

¹²⁵ S 164(9)(b)

¹²⁶ S 164(10)

¹²⁷ S 164(9)(c)

¹²⁸ Either after the (i) day on which the action approved by the resolution is effective; (ii) the last day for the receipt of demands (iii) the day the company received a demand

¹²⁹ S 164(11)

¹³⁰ S 164(16)

¹³¹ The reasoning is that the value of the company's shares might have dropped as a result of the resolution. The resolution might have a negative impression on the outside world which would not make the shares of the company attractive anymore.

¹³² S 164 (11)

shares must not be discriminatory or different or vary in terms in any manner whatsoever. It must be on the same terms.¹³³ The company is not permitted to use the fair value as a vendetta to shareholders or targeted at particular persons. This could happen in instances where the directors pinpoint an individual as the “architect” of the action and wants to use the opportunity to get back at such individual.

A shareholder who has been made an offer has 30 business days to accept the offer.¹³⁴ But where the offer is not accepted, it lapses and the shareholder’s right is restored. In the instance where the shareholder accepts the offer before it lapse, the shareholder must tender the share certificates to the company or its agent¹³⁵. However where the shares are not certificated, the shareholder must transfer the shares back to the company or its agent.¹³⁶

f. Application to courts

The company is mandated to pay the shareholder the agreed amount within ten business days after the shareholder accepted the offer and tendered the shares certificate back to the company or transfers the shares back to the company.¹³⁷ But on the other hand, if the shareholder disagrees with the value of the shares as determined by the board or the company fails in totality to make an offer to the shareholder, the shareholder would make it known to the company and can apply to the court to determine the fair value of the shares in question and also for an order requiring the company to pay the fair value as determined by the court.¹³⁸ The ground for such application is that the offer made by the company is inadequate.¹³⁹ It must be noted that the offer made by the company must not have lapsed before the

¹³³ S 164 (12)(a)

¹³⁴ S 164(12)(b)

¹³⁵ S 164(13)(a)(i)

¹³⁶ S 164(13)(a)(ii)

¹³⁷ S 164(13)(b)

¹³⁸ S 164(14)

¹³⁹ S 164(14)(b)

application is brought to the court.¹⁴⁰ If the offer lapses, the shareholder is deemed to have been restored to his position as a shareholder and the application would be lacking in merit.

In bringing an application to the court, all other dissenting shareholders who have not accepted the offer of the company, if any, must be joined in the action.¹⁴¹ The court may also determine whether a particular shareholder is dissenting and should be joined in the application or not.¹⁴² The decision of the court is thus binding on the shareholder, if he is joined in the action.¹⁴³ In such an application, the implication, consequence and right of participation in such proceeding should be made known to the joined shareholder.¹⁴⁴ The essence of this practise would be to avoid multiple litigations against the company based on the same issue of determining the fair value.

g. Orders of Court

The court in determining the application may make certain orders. The court must determine the fair value of the shares in question.¹⁴⁵ The determination of the value must be based on the assessment of the value as at the time immediately before the resolution was adopted.¹⁴⁶ Upon determination of the value, the court must order the company to pay the fair value in respect of their shares to the dissenting shareholders who have perfected¹⁴⁷ their stand in the proceeding.¹⁴⁸ This could be subjected to any condition as pronounced by the court.

¹⁴⁰ Ibid

¹⁴¹ S 164(15)(a)

¹⁴² S 164(15)(c)(a)

¹⁴³ S 164(15)(a)

¹⁴⁴ S 164(15)(b)

¹⁴⁵ S 164(15)(c)(ii)

¹⁴⁶ S 164(16)

¹⁴⁷ Shareholders who have fulfilled the condition of the appraisal remedy and have either tendered their share certificates or transfer same to the company.

¹⁴⁸ S 164(15)(c)(v)(bb)

However, the court may make an order requiring the shareholder to withdraw his demand on the company and revert back to being a shareholder, or order the shareholder to transfer his shares back to the company or tender his share certificates to the company.¹⁴⁹

h. Variation of terms

Consequent upon the determination and acceptance of the fair value by the dissenting shareholder, the company can apply to the court for variation of the terms of payment. The ground for such application would be on the fact that the company, if it goes ahead to pay the money, would not be able to pay its debt or financial obligations as they fall due within the ensuing 12 months.¹⁵⁰ The facts backing the ground must be reasonable and substantiated. The court is meant to make a just and equitable order taking into consideration the financial circumstances of the company. The court must make an order that ensures the dissenting shareholder is paid at the earliest possible date compatible with the company satisfying its other financial obligation as at when they fall due.¹⁵¹ But the order earlier given must be seen to be complied with alongside the order of variation. It is reasoned that if the company is allowed to vary the payment indefinitely till when financially sound based on the order, it is my view that the purpose of the procedure would have, if not defeated, been delayed

However, the question arises, what would be the fate of a shareholder who accepts the offer of the company, negligently, where the court determines the fair value to be higher than what he was paid? Would he be allowed to bring an action for review of the value he was paid? If he is denied, would it not be contrary to the intention of Section 164(12) (a)¹⁵² which seeks to make all shareholders with the same class of shares to be given the same value? These are some of the issues yet to be pronounced on by the court.

¹⁴⁹ S 164(15)(c)(v)(aa)

¹⁵⁰ Section 164(17)

¹⁵¹ Section 164(17)(b)(ii)

¹⁵² "Every offer made under subsection (11) in respect of shares of the same class or series must be on the same terms".

3.5 Remedy: purpose well-served?

The remedy is a welcome development as it gives the shareholder the opportunity to exit the company with his cash which is of fair value. The mechanism is actually a “no-fault” action as the shareholder need not prove any wrongdoing on the part of the company or director. The only ground for action is the happening of the triggering event. Once the company gives a notice or adopts a resolution on the triggering events, the appraisal right of the shareholder is activated.

It is a “win-win” situation for the parties. In the instance where the transaction would be of tremendous benefit to the company, the company would be able to go ahead with the transaction, as against when the shareholder would have vetoed the transaction. The parties are able to achieve their aims without hampering the progress of one another. While the dissenting shareholder is able to leave the company with his money intact, the company is also able to carry on with its plan without being hindered by the minority.

The most laudable characteristics of the appraisal remedy is the little or non-involvement of the court in the remedy. The court is not involved in any way in the remedy except in the instance where there is a disparity as to the fair value of the share involved or where the company cannot pay the offered value due to financial constraint and it applies to the court for variation. Interestingly, this is an aspect of the remedy that may not be used if the company and the shareholder agree as to the fair value of the shares. It is noted that the shareholder only makes an application to the court where the company has decided not to make an offer to the shareholder or where the offer made is deemed inadequate. Hence, where the shareholder accepts the offer made by the company, the approach of the court would have been discarded with. This is really laudable as it speeds up the process and avoids unnecessary delays associated with other remedies and court processes.

However with the introduction of the remedy, would it be said that the minority shareholders are now well protected? With the advent of the appraisal right, is the minority now free from the oppression of the majority?

The remedy has come to reduce the oppression of the minority. The approach of the remedy is indeed very helpful. But the remedy is not devoid of its own fault and criticism.

Most notable criticism of the remedy is the technicalities involved in the procedure. The non-adherence to any of the rules or procedure might jeopardise the chance of the dissenter making use of the remedy. The procedures are laden with technicalities and keen time frames. The tone of the procedure makes it important that none of the steps or time frame be taken for granted. The constant use of the word “must” is noted as making such procedure mandatory. The remedy is a procedure mainly making use of time-frames. The observation of such timing is important as it may make the application invalidated in court. The timing of the notices and observance of rules brings in a lot of technicalities which invariably put the shareholder under a lot of pressure, and sometimes result in the shareholder making hasty decisions. The shareholder, as noted by a scholar, must meticulously comply with each procedural step in order to perfect and to exercise the appraisal right.¹⁵³ This she likened to a minefield for the shareholder.

Another evident fault of the remedy is the non-defining of the means of determining the fair value. The fair value of the shares is to be determined by the Board and must be adjudged to be fair. But in what manner should the value be calculated? The Act is silent on this and it gives a lee-way for the company to manipulate the value of the share. The manner by which values are been determined is looked into in the thesis.

As an offshoot from the above criticism, as rightly noted,¹⁵⁴ the thought of the court awarding an adverse cost against the shareholder might make the shareholder succumb easily to the fair value as put forward by the company. The idea of the court not getting involved in the remedy might not be helpful after all and haunt the applicant thereafter. The cost of seeking determination in court and thought of possible cost by the court might make the shareholder succumb to the whim of the majority. This would definitely not be in the advantage of the shareholder. This might make the applicant sceptical about the process before pursuing the remedy in court. However this would have been addressed had the Act made provision for ways and manner of determining the exact value of the shares. This would have enabled the shareholder to judge his chances and opt for the less-financially burdened option.

¹⁵³ F.H Cassim et al *Contemporary Company Law* 2nd Ed, JUTA CO LTD 2012

¹⁵⁴ *ibid*

Another noted challenge of the remedy is that it is only applicable in certain events and not as a general shield for the minority. The triggering events are as stated in Section 164. Any other event outside that would have to be addressed using other remedies. But the result of such remedies would not necessarily allow the minority exit the grips of the majority, which should actually be the resultant effect of any action by the minority against the majority. The minority would still be locked in the company with the “bullying” majority. The minority should be able, upon oppression from the majority, be able to exit the grip of the majority, as of right and protect their interest.

3.6 Conclusion

As previously discussed, the remedy is set about with rigorous and timeous procedures. However the failure of the Act to provide the procedure or manner of determining the fair value of the shares is a critical flaw of the remedy.

The remedy is a well-practiced remedy in the developed countries. The next chapter examines the remedy as practiced in the Delaware Jurisdiction and subsequently how the fair value is determined in the jurisdiction.

CHAPTER FOUR

APPRAISAL RIGHT IN DELAWARE JURISDICTION

4.1 Introduction

As discussed in previous chapter, the appraisal right is an innovation in the South African Companies Act 2008. The remedy is widely used in developed countries. Similar to the South African remedy is the remedy in the Canadian Jurisdiction. The legislation in this regard in South Africa is identical to the Canadian legislation.¹⁵⁵ This chapter looks at the appraisal remedy in the Delaware Jurisdiction in the United States. The choice of Delaware jurisdiction stems from the extensive practise in the Jurisdiction and the widely acknowledged practise.¹⁵⁶

The Appraisal right procedure is viewed under the headings: notice from the company, demand by the stockholder, appraisal petition, hearing of petition and withdrawal of right. Conclusively, the chapter compares the application of the remedy as operated under the two jurisdictions.

4.2 Position Prior to Appraisal Right

According to Balotti and Finkelstein¹⁵⁷, originally in Delaware, fundamental transactions¹⁵⁸ were sanctioned by unanimous decisions of the stockholders. This means the consent and approval of all the corporation's stockholders with regards to the transaction must be obtained. The court noted that at common law there was no provision for an appraisal because unanimous consent of the stockholders was necessary to warrant certain acts such as consolidation or mergers.¹⁵⁹ The non-approval of a stockholder nullified the process. This gave a minority or a single stockholder the right to veto transactions, which made the stockholder hold the

¹⁵⁵ Section 190 Canada Business Corporation Act 2001 This is an observation considering the examination of the Acts in both jurisdictions.

¹⁵⁶ Lazar Sarna *Corporate Structure, Finance and Operations: Essay on the Law and Business Practice* Volume 2 The Carswell Company Limited, 1982, p 379

¹⁵⁷ R. Franklin Balotti and Jesse A. Finkelstein "*The Delaware Law of Corporations and Business Organisations*" Third Edition, Volume 1 Aspen Publishers 2009

¹⁵⁸ Mergers, Consolidations, Transfer of all or substantially all the corporation's asset

¹⁵⁹ *Re Appraisal of ENSTAR Corp.*, C.A No 7802 (Del.Ch July 17, 1986, slip op, at 10

company to ransom in most cases.¹⁶⁰ This put the company in a bad situation and opened it up to giving undue consideration to the minority. In an attempt to rectify this situation, the enabling statute discarded the provision for unanimous consent and approval by all stockholders. This enabled the majority to carry out transactions even when the minority opposed the transaction. In a bid to pacify the minority for the lost power, the statute introduced the appraisal right which allowed the minority to leave the company with the value of their shares. In *Chicago Corp. V Munds*,¹⁶¹ the court observed that

'At common law, it was in the power of any single stockbroker to prevent a merger. When the idea became generally accepted that, in the interest of adjusting corporate mechanism to the requirements of business and commercial growth, mergers should be permitted in spite of opposition of minorities, statues were enacted in state after state which took from the individual stockholder the right therefore existing to defeat the welding of his corporation with another. In compensation for the lost right, a provision was written into the modern statues giving the dissenting stockholder the option completely to retire from the enterprise and receive the value of his stock in money.'

In summary, it can be said that the justification for the introduction of the remedy is:

- To compensate the minority for the loss of their veto power
- To enable a cash exit from the corporation, instead of been forced to stay in the corporation against their wish, and
- To enable the majority to carry out corporate transactions.¹⁶²

Before examining the appraisal right in Delaware jurisdiction, appraisal right is examined in the United State under the Model Business Corporate Act 2002.

¹⁶⁰ *Chicago Corp. V Munds* 172 A. 452, 455 (Del. Ch. 1934) – “At common law it was in the power of any single stockholder to prevent a merger”

¹⁶¹ 172 A 452. 455 (Del Ch. 1934) Also in In *GOOD V LACKWANA LEATHER COMPANY*...233 A 2D201 (N.J. Super Ct Ch. Div. 1967)... the nature of the right to dissent was underscored by stating that the general reason for dissenters’ right is that shareholders should not be forced against their will into something fundamentally different from that which they impliedly bargained when they acquired their shares

¹⁶² Hagan K. J. “*First Western Bank Wall v Olsen*: An interpretation of „Fair Value“ for Minority Shares as Found within the South Dakota Dissenter’s Rights Statutes” (2003) Vol. 48 *South Dakota Law Review* 83 at 89-90.

4.3 Appraisal Right in the United States¹⁶³

Generally in the United States, the appraisal right remedy is governed by Section 13.02 of the Model Business Corporate Act (MBCA).¹⁶⁴ It provides that:

“A Shareholder is entitled to appraisal rights, and to obtain payment of the fair value of that shareholder’s shares, in the event of any of the following corporate actions:

(1) consummation of a merger to which the corporation is a party (i) if shareholder approval is required for the merger by section 11.04 and the shareholder is entitled to vote on the merger; except that appraisal rights shall not be available to any shareholder of the corporation with respect to shares of any class or series that remain outstanding after consummation of the merger; or (ii) if the corporation is a subsidiary and the merger is governed by section 11.05;

(2) consummation of a share exchange to which the corporation is a party as the corporation whose shares will be acquired if the shareholder is entitled to vote on the exchange, except that appraisal rights shall not be available to any shareholder of the corporation with respect to any class or series of shares of the corporation that is not exchanged;

(3) consummation of a disposition of assets pursuant to section 12.02 if the shareholder is entitled to vote on the disposition;

(4) an amendment of the articles of incorporation with respect to a class or series of shares that reduces the number of shares of a class or series owned by the shareholder to a fraction of a share if the corporation has the obligation or right to repurchase the fractional share so created;

(5) any other amendment to the articles of incorporation, merger; share exchange or disposition of assets to the extent provided by

¹⁶³ Reference is made to the Model Business Corporate Act as all states in the United State adopt it as the basic law for appraisal right.

¹⁶⁴ Presently, the latest version of MBCA was released in 2002

the articles of incorporation, bylaws or a resolution of the board of directors;

(6) consummation of a domestication if the shareholder does not receive shares in the foreign corporation resulting from the domestication that have terms as favourable to the shareholder in all material respects, and represent at least the same percentage interest of the total voting rights of the outstanding shares of the corporation, as the shares held by the shareholder before the domestication;

(7) consummation of a conversion of the corporation to non-profit status pursuant to sub-chapter 9C; or

(8) consummation of a conversion of the corporation to an unincorporated entity pursuant to subchapter 9E.¹⁶⁵

This is the fundamental basis of the application of the remedy in most States in the United States. Section 13.01 (3) states the fair value is to be determined immediately before the implementation of the corporate action, rather than, as is the case under most state' statutes that address the issue, the date of the shareholders' vote.

The procedure under the Model Business Corporate Act is, in a nutshell:

- The stockholder must not have voted for the resolution
- He must file a written notice of his intent to demand payment within 30-60days
- The notice must be given before the vote for the resolution is taken; else he is barred from exercising the right.
- Resolution notice to the dissenters must be given within 10days.
- The resolution notice must detail where and when the demand for payment must be sent and in what manner the shares will be exchanged.
- Upon regularising, the corporation must pay the fair value with the financial statement and explanatory note.
- If the dissenter does not agree, he can then propose his own value in line with the value, interest due and the demand payment.

¹⁶⁵ Section 13.02 MBCA

- If no compromise, the corporation must commence a judicial valuation proceeding

Interestingly, each State applies the basics in their jurisdiction differently. The scope of the practise is different in each State's jurisdiction. For example, in California, the remedy is mainly used in merger and consolidations, whereas in other States it extends to amendments to the articles as well as transfer of assets.¹⁶⁶ Each State is permitted to formulate its own laws around the MBCA basics, with little modifications.¹⁶⁷ In the Delaware Jurisdiction in focus, the appraisal right remedy is mainly exercised in merger and consolidation. The governing statute is the Delaware General Corporation Law.¹⁶⁸

4.4 Procedure under the Delaware Jurisdiction

The Delaware General Corporation Law provides for the remedy in Section 262. The section outlines the triggering events and procedure for the remedy. The detail of the procedure is discussed below.

a. Notice from the Company

The statute mandates the corporation to issue notice to each of its stockholder that is entitled to appraisal right, in anticipation of the merger or consolidation.¹⁶⁹ The notice must be sent twenty days prior to the convening of the meeting where the merger or consolidation proposal would be discussed.¹⁷⁰ The notice must be accompanied by a comprehensive statement notifying the stockholder of his right of appraisal.¹⁷¹ This had been held to be a valid ground of excuse on behalf of the stockholder if caught by failure to comply with the procedure due to insufficient information.¹⁷²

¹⁶⁶ Vorenberg J. "Exclusiveness of the Dissenting Shareholder's Appraisal Right (1964) No. 7 *Harvard Law Review* 1189 at 1207

¹⁶⁷ Ibid

¹⁶⁸ Hereafter called " the statute"

¹⁶⁹ Del. Corp. Section 262(d)(1)

¹⁷⁰ Ibid

¹⁷¹ Ibid

¹⁷² *Raab V Villager Industry Incorporation* 355 A.2d 888, 894 (Del. 1976)

b. Demand by the Stockholder

Upon resolving to disagree with the resolution, the stockholder must submit a written demand for appraisal to the corporation before the vote for the resolution for merger or consolidation.¹⁷³ The demand, which must disclose the identity of the stockholder, must be precise, stating the intention of the stockholder to demand the appraisal of its shares.¹⁷⁴ It is duly noted that a vote or a letter of proxy against the resolution is not a demand in any form.¹⁷⁵ Also of significance is the timely demand on the corporation within the timeframe by the statute. Failure to meet the time frame would amount to loss of the right.

The corporation must notify each stockholder, who did not vote for the resolution and has made a demand on the company, that the merger has been effected. This must be within ten days of the effective date.¹⁷⁶ But in the instance that the merger is a short-form merger or by written consent, the notice must be before the effective date or ten days after.¹⁷⁷

The Stockholder, having fulfilled the requirements, may make a demand on the corporation for a statement, highlighting shares pertaining to him. The statement must be mailed to him within ten days of the receipt of such demand or ten days after the expiration of the period of delivery for demands of appraisal.¹⁷⁸ The purpose is for the stockholder to be aware of the dissenters initiating the right. This might influence his decision to file an appraisal petition.

c. Petition for Appraisal

The petition for an appraisal can be filed within one hundred and twenty days after the effective date of merger.¹⁷⁹ The petition can either be filed by the corporation or

¹⁷³ Del. Corp Section 262(d)(1)

¹⁷⁴ Ibid

¹⁷⁵ Ibid

¹⁷⁶ Del. Corp., S262(d)(1)

¹⁷⁷ Del. Corp., S262(d)(2)

¹⁷⁸ Del Corp., Section 262(e)

¹⁷⁹ Del. Corp Section 262(e)

any stockholder who qualifies for the right.¹⁸⁰ It is filed at the Delaware Court of Chancery, demanding a determination of the value of the stock of all stockholders demanding the appraisal.¹⁸¹

After the filing of the petition, the corporation must within twenty days file with the register in Chancery a verified list containing the names and addresses of all stockholders. These stockholders must have demanded payment for their shares and an agreement or settlement had not been reached.¹⁸² It is noted that the verified list is being filed alongside the petition, if the petition was filed by the corporation at the first instance.¹⁸³

Section 262(f) provides for general notice to the parties and public with respect to the hearing. Notice is sent to the corporation and the parties, as well as the stockholders on the verified list, by registered or certified mail. The notice must state the time and exact place for the hearing. The registrar of the chancery must issue a notice in a newspaper with general publication in the City of Wilmington, Delaware or as approved by the Court, at least a week before the day of hearing. The cost of the notice and publication is borne by the corporation.

Section 262(g) makes provision for the hearing of the petition. As of practice, the court mandates two hearings for the petition. The first hearing is for the corporation to raise objections to the claim of stockholders, with respect to stockholders who had not perfected their rights. The second hearing is for the stockholders to rebut claims of the corporation where need be, and assert their right. Each stockholder asserts his right individually and not collectively. In *Re Universal Pictures Incorporation*,¹⁸⁴ the court observed that the burden falls upon a dissenting stockholder to establish his right to an appraisal and payment. Likewise in *Tabbi V Pollution Control Industry*

¹⁸⁰ Ibid

¹⁸¹ Ibid

¹⁸² Del. Corp., Section 262(f)

¹⁸³ Ibid

¹⁸⁴ 37 A.2d 615, 618 (Del. Ch. 1944)

*Incorporation*¹⁸⁵, the court affirmed that the party seeking appraisal bears the burden of proving compliance with the requirements of Section 262.

The court also determines which stockholder has perfected his right and entitled to the remedy. The court reserves the right to dismiss the claim of stockholders who had not sufficiently proved his perfection of the right.

d. Withdrawal of Right

The right of appraisal does not become operational until sixty days after the effective date of the merger or consolidation. In effect, during this period, the stockholder can withdraw his demand on the corporation and accept the terms on offer under the merger or consolidation.¹⁸⁶ But the written request of the corporation would be needed after the sixty days benchmark of the effective date. Also, where the petition has been filed, court approval is needed before the stockholder can withdraw.¹⁸⁷

4.5 Comparative Analysis

The appraisal right procedure under the South African Jurisdiction and the Delaware Jurisdiction are similar in their application. Foremost, the triggering event for the remedy is similar in both jurisdictions. The triggering event of sale of all or major part of business and alteration of the article with reference to share rights are added in the South African jurisdiction.

Likewise, the procedural requirement for notice of meeting by the company; voting in the meeting, written demand by the shareholder for appraisal on the company; notice of resolution to proceed with the transaction, issuance of statement showing shares are all similar in nature and practise in the jurisdictions.

4.5.1 Notable differences in the practice in the jurisdictions:

a. Petition: In the South African jurisdiction, the shareholder is saddled with the responsibility of making the petition for determination of the fair value. This must be made by the shareholder before the offer made by the company lapse. The company is not mandated to bring the application. This gives the company an edge over the

¹⁸⁵ 508 A.2d 867, 869 (Del. Ch.1986)

¹⁸⁶ Del. Corp., Section 262(e)

¹⁸⁷ Del Corp., Section 262(e)

shareholder in the appraisal proceeding. The company may stall in the decision to bring the application, but the shareholder must act timeously; else he would be barred from the court application. The corporation is not at a loss if the process of the application is stalled or not made to the court. In the Delaware jurisdiction, on the other hand, the corporation as well as the stockholder can approach the court for determination of the share value. One of the parties can bring the application on the reluctance of the other party. The corporation especially is timeous in bringing the application. In defiance of the timing, the amount in dispute, raised by the stockholder would be binding on the parties.

b. Notice of petition: In the Delaware jurisdiction, the statute mandates the publication of the process in the newspaper generally acceptable within the jurisdiction. Also, the notice of the petition hearing must be sent to the corporation, stockholders and other dissenting stockholders through registered mail. This is a commendable feature, which is regrettably absent in the South African practise.

c. Verified list: Both jurisdictions mandate the parties, while in court, to join other dissenting shareholders to the action. In the Delaware jurisdiction, the comprehensive list must be filed in court along with the petition. In South Africa, however, the company is not mandated to file the list, though the shareholder must join other dissenting shareholders in the application. This is a task for the shareholder which would have been made easier if the company were mandated to produce the list, as it is easier for the company to make the list available.

4.6 Conclusion

The application of the remedy in the jurisdictions is with differences in the mode of instituting the application. The South African jurisdiction has to learn from the Delaware jurisdiction in the application of the remedy with reference to instituting an application for the remedy in court. The mode of instituting the petition in court is easier under the Delaware Jurisdiction than in South Africa.

Regrettably, as earlier shown in the South African Act, the means by which the fair value is to be determined is not specified. Unexplainably, in Delaware Jurisdiction, the Act also does not state the means of determining the fair value of shares. This is likely to create a vacuum in the administration of the remedy. This has led to the use of different methods to calculate the fair value. In Delaware jurisdiction, the vacuum

had been filled through the years by applying methods of valuation, which have been beneficial to the jurisdiction. The next chapter deals with methods of valuation of shares as applied in Delaware jurisdiction.

CHAPTER FIVE

FAIR VALUE: HOW DETERMINED?

5.1 Introduction

One of the main features of the appraisal right remedy is the determination of the share value. The remedy affords the dissenter an exit from the company with his fair value as against staying locked in the company. But how is this value determined?

The Delaware Act guarantees the remedy but unexplainably does not provide a means to determine the value. The Act affirms that the fair value of a share is to be determined taking into consideration the standing of the company as at the time before 'the date on which, and the time immediately before' the company adopted the resolution that brought about the action.¹⁸⁸

Fair value is an estimate of a security's worth in the open market. There is no one way to calculate the fair value for a security. It is generally accepted that consideration is given to factors such as the company's profit margin, rate at which the company expands, and importantly, the risk the company is exposed to.¹⁸⁹ As noted, in most private companies, the value of minority shares is unattractive to the outside buyer. This is due to the restriction of the transfer of the shares by the company's article, coupled with the fact that the position of a minority shareholder is not enviable. This explains why the shares have to be valued accordingly with negotiation.¹⁹⁰

In South Africa, there has not been a case law where the court has had course to deal with value. This is due to the remedy being new in the jurisdiction. This necessitates the reason for the examination of the valuation of shares under the Delaware statute.

This chapter considers mainly the following means of valuation which have been used by the court in Delaware: Companies Acquisition Method, Comparable

¹⁸⁸ Del. Corp. Section 262(h)

¹⁸⁹ Online Financial Dictionary <http://www.investinganswers.com/financial-dictionary/stock-valuation/fair-value-995>

¹⁹⁰ Andrew Hicks & S.H Goo, "*Cases & Materials on Company Law*" 4th Edition, Blackstone Press Limited, 2001, Pp. 268

Company Approach, the Delaware Block Method of valuation and the Discounted Cash Flow Analysis.

5.2 Methods of valuation of shares

The methods of valuing a corporation varies based on the fact and discretion of the courts as to the reliability and accuracy of the methods.¹⁹¹ These methods, which had been applied effectively by the courts, are now discussed.

A. The Companies Acquisition Method

This is a valuation approach where the company's potential sale price is derived by identifying similar companies in the transactions.¹⁹² The company is placed at par with a similar company in a similar transaction. Factors that are considered in this method include profit, size of transaction, the timing of transaction and the comparability of the companies involved.¹⁹³

In the method, the value of the comparable transaction is calculated as a multiple of a financial measure, mainly using the company's financial record for the past 12months. This helps in arriving at a specific value resulting from the computation. To get the per share value, the sale price is divided by the number of shares.

A simplified explanation was given by the Court of Chancery in *Highfields Capital Limited V Axa Financial Incorporation*¹⁹⁴. The court stated:

'A comparable transaction analysis is an accepted valuation tool in Delaware appraisal cases. The analysis involves identifying similar transactions, quantifying those transactions through financial metrics and then applying the metrics to the company at issue to ascertain a value. The utility of the comparable transaction methodology is directly linked to the "similarity between the company the court is valuing and the companies used for comparison.'

¹⁹¹ *Cooper V Pabst Brewing Company* C.A. No 7244 (De. Corp. June 8, 1993), slip op at 20

¹⁹² R. Franklin Balotti et al supra

¹⁹³ *Le Beau V M.G. Bancorporation, Incorporation* C.A. No 13414 (Del. Ch. Jan. 29, 1998) slip op at 7,30-31

¹⁹⁴ 939 A.2d 34, 46 (Del. Ch. Aug. 17 2007)

Despite the pronouncement of the court with reference to the method, the court sparingly used the method. The court found it suitable in valuing a corporation, in the ordinary course of business, but it posed a problem with a company undergoing merger and acquisition.¹⁹⁵ Data, such as synergies with the acquiror involved in the transaction ought to be discarded in the computation, which the method failed to deal with.¹⁹⁶ In *Kleinwort Benson Ltd V Silgan Corporation*¹⁹⁷, the court noted that the merger and acquisition approach necessarily incorporates control premiums and liquidation values that produce inflated values that do not accurately reflect the going concern value of the company at issue.

B. The Comparable Company Approach

The comparable company approach involves the comparison of two similar companies. The first step under this approach is to identify comparative companies. This is based on the products of the companies, capital structure, personnel, revenues, earnings, book value, growth prospects and risk.¹⁹⁸

The second step is to derive financial measures that can be used to compute the value of the subject company. The Earnings Before Interest and Tax (EBIT) or Earnings Before Interest, Tax, Depreciation and Amortization (EBITDA) are suggested measures. This depends on the type of company to be valued. The enterprise value of each comparable company is divided by the financial measure to derive a ratio that states each company's value as a multiple of the financial measure. This results in an appropriate range of multiples. Once the calculations are done, the appropriate financial measure of the company in question is capitalized using the relevant multiple or range of multiple to derive a total value of the stockholder's equity. The total equity value divided by the number of shares yields the per share value of the stock.¹⁹⁹ This method of valuation was approved in *Onti Incorporation V Integra Bank*.²⁰⁰

¹⁹⁵ *Re Appraisal of Shell Oil Company* C.A No8080 (Del. Ch. Dec. 11, 1990)

¹⁹⁶ R Franklin Balotti et al supra.

¹⁹⁷ C.A. No 11107 (Del. Ch. 15, 1995) at 9

¹⁹⁸ *Harris V Rapid-Am. Corporation* C.A. No 6462 (Del. Ch. Oct. 2, 1990)

¹⁹⁹ R Franklin Balotti et al supra

C. The Delaware Block Method

This is one of the most practised methods in the Delaware jurisdiction. The method was exclusively applied to appraisal rights before the judgement of the Delaware Supreme Court in *Weinberger V UOP Incorporation*²⁰¹. It is a combination of three means of calculation, namely the asset value approach, the market value approach and the earning approach. These three methods are examined.

1. The Asset Value Approach

This is a valuation method that treats the corporation as a going concern, in relation to its assets-intensive industry. The asset valuation method treats the share as a liquidation value. The theoretical liquidation value is computed based on the fair market value of the corporation's assets as of the date of the merger.²⁰² This is determined as an agreement between a willing seller and buyer, under a usual and non-compelling market situation.²⁰³ But in the instance that a market value cannot be determined, the book value of the asset is used as a basis for estimating the liquidation value.²⁰⁴

In grand determination, the court sums up the aggregate of the assets to get the actual valuation of the corporation.

2. The Earnings Approach

This is a valuation method as regards the earnings of the corporation as well as its capital. This is viewed as a whole, before the deductible taxes.²⁰⁵ The earning of the corporation is viewed as a great prospect giving a trend of how future earnings would be estimated.

In calculating a corporation's earning, the average earning of the corporation is calculated over a set period of time, immediately before the merger. The set period

²⁰⁰ 751 A. 2d 904, 915 (Del. Ch. 1999)

²⁰¹ 457A. 2d 701 (Del. 1983)

²⁰² *Re Vision Hardware Group Incorporation* 669 A.2d 671, 679 (Del. Ch. 1995)

²⁰³ *Poole V N.V Deli Maatschappij*, 243 A.2d 67, 70 n.1 (Del. 1968)

²⁰⁴ *Levin V Midland-Ross Corporation* 194 A.2d 853, 854 (Del. Ch.1963)

²⁰⁵ The deductible includes tax, depreciation, interest rates and amortization.

must reflect the profits and loss incurred by the corporation, to show its viability. The set period is not fixed. The court favours a more accurate calculation that is effective. A five-year period was accepted in *Tannetics Incorporation V A. J. Industry Incorporation*²⁰⁶ where the court stated that the customary period of time over which to compute such average is ordinarily fixed at the five year period immediately preceding the merger. But in *Gonsalves V Straight Arrow Publishers Incorporation*²⁰⁷ the trial court held that the court is not bound to adopt a five year period.

After determining the average earning, it is capitalized using the capitalization or multiplier rate. The capitalization rate is obtained through a comparison with similar publicly traded companies whose market capitalization and earnings measures are publicly disclosed.²⁰⁸ The capitalization rate is often the price to earnings ratio. This is adjusted by the court taking into considerations factors including patterns of the corporation's business, risk taken by the corporation, financial capacity and so on. This is done solely at the discretion of the court.

At the last step, after getting the multipliers, the average of the earning figure is multiplied by the earning multiplier to get the earnings valuation. The result is added to the non-operating assets of the corporation to get the total value of the corporation. The total value is divided by the number of shares in the corporation to give the value per share.

3. The Market Value Approach

In the Block Method valuation, the market value is a relevant factor to be considered. It is ascertaining what the value of the corporation is, as at the time of the merger. It throws a big weight in the calculation of the value of the company. The most reliable value of the corporation with respect to a market value is through a selling process where the buyers are competitive. In such instances as an auction²⁰⁹, the buyers are saddled with information as to help their valuing of the corporation and put on

²⁰⁶ C.A No. 5306 (Del. Ch. July 17, 1979) slip op at 11

²⁰⁷ 701 A.2d 357, 361-62 (Del. 1997)

²⁰⁸ *Gonsalves supra* at 12

²⁰⁹ In an auction process, the prospective buyers are given salient information, some which are not even in the knowledge of the public. This is to help in estimating the worth and trend of the corporation. The prospective buyer, putting in the bid, gives an estimate of the value of the corporation in the market.

competitive bids. This helps to ascertain a reliable value of the corporation. But it must be noted that where the transaction process is tainted with fraud, inflation, “transaction in pipeline” and single dominant buyer, it cannot give a true value of the corporation.²¹⁰

Application

In the Block Method, the three methods are used in calculating the value of the corporation. After the derivation of the value of the company using the three methods, the court determines the percentage weight to grant each method in calculating the final value. The factors vary from manner of calculation and the characteristics of the corporation. For instance, the Asset value gains more weight for natural resources firms because “the worth of a natural resource company lies in the value of its underlying assets”.²¹¹

After assigning the appropriate weight percentage, the court calculates the weighted average of the three valuations. This forms the appraisal value of the subject company. This was well enunciated in the case of *Rosenblatt V Getty Oil Corporation*.²¹²

This method is significant and widely recommended due to its consideration of every influencing factor of the company. Each method is not made a controlling factor of the valuation. Until recently this method had gained acceptability and wide applicability.²¹³

One of the noted issues with the method is assigning of weighted percentage to each of the three means of calculation. The Block Method is no longer an exclusive method of calculating value of shares due to modern means of calculating the value of shares, as discussed next.

²¹⁰ Balotti supra p 9-145

²¹¹ *Neal V Ala. By-Prosds Corporation* C.A No. 8282 (Del. Ch. Aug 1 1990) slip op.at 15, aff'd, 588 A.2d 255 (Del. 1991)

²¹² 493 A.2d 929, 934 n.6 (Del. 1985)- explaining that under the Delaware block Method “elements of value, including assets, earnings and market price are given a dollar figure, assigned a percentage weights and then summed to yield a weighted average value per share”

²¹³ This is prior to the WEINBERGER CASE

D. The Discounted Cash Flow Analysis (DCF)

Arising from the Block Method of valuation, the courts have accepted a new means of calculating the fair value of the corporation, which is adjudged to be more accurate and reliable than other means of calculation.²¹⁴

In the Weinberger²¹⁵ case, the Delaware Supreme Court affirmed that

‘The standard ‘Delaware block’ or weighted average method of valuation, formerly employed in appraisal and other stock valuation cases, shall no longer exclusively control such proceedings. We believe that a more liberal approach must include proof of the value by any technique or methods which are generally considered acceptable in the financial community and otherwise admissible in court, subject only to our interpretation of section 262(h)’.²¹⁶

This gave birth to the Discount Cash Flow Analysis method²¹⁷.

The DCF Method is based on the assumption that the value of the company is the same as the present value of its projected future cash flows.²¹⁸ The method is made up of three main steps; namely

1. The cash flow projections

An analysis is carried out on the corporation to estimate the future cash flow of the corporation over a specified period of time. The specified period is reasonably for a period of five years though a shorter period could be used if it guarantees a reliable and accurate result.²¹⁹ The result determined is central to the efficiency of the valuation method.²²⁰ It must be noted that the projection made must not include the

²¹⁴ *Pinson V Campbell-Taggart Incorporation* C.A No 7499 (Del. Ch. Feb 28, 1989) slip op at 23 n.11

²¹⁵ Supra

²¹⁶ Ibid. p 712-713

²¹⁷ *Onti Incorporation*, supra, 904, 916

²¹⁸ *Neal V Ala. By-Prosds Corporation* supra

²¹⁹ *Grimmes V Vitalink Commc’ns Corporation* C.A. No 12334 (Del. Ch. August 26, 1997, modified Sept. 17, 1997), slip op at 2

²²⁰ *Gilbert v M.P.M Enters., Incorporation* 709 A.2d 663, 669 (Del. Ch. 1997) - to obtain the most accurate cash flow forecast, it is necessary to start the forecast with accurate, up-to-date financial data.

result expected from the merger or consolidation. But the pre-merger projection of the corporation may be used if accepted by the parties.²²¹

2. The Terminal Value

The terminal value is referred to as the present value of the company's future cash flows. This is referred to from the period already estimated from the cash flow analysis. This may be determined by using the present value of the corporation's cash flows already projected²²², or by using a capitalized earning approach.²²³

3. The Discount rate

This is the final step in determining the present value of the annual cash flow. This is mainly used for efficiency as it has a profound effect on the outcome of the analysis. The discount rate may be derived using an industry-specific methodology. The rate is mainly derived from the company's weighted average cost of capital,²²⁴ calculated from its cost of debt and cost of equity. Afterwards, a weighted average of the corporation is determined based on the company's actual capital structure as at the date of the merger.

Computation

After the determination of these three main inputs, the calculation of the value of the corporation is done. The total present value of cash flow is derived by addition of the discounted cash flow and terminal value. Afterwards, the value of non-operating assets is added. The fair value per share of the company is derived by dividing the result from the addition by the total number of shares in the corporation.

5.3 Conclusion

The appraisal remedy practice in Delaware jurisdiction has been extensive, spanning many years of application and efficiency. The Chancery court, which is saddled with

²²¹ *Cede & co V JRC Acquisition Incorporation* C.A No 18648 (Del. Ch. Feb. 10 2004) slip op at 5 – This court prefers valuations based on management projections available as of the date of the merger and holds a healthy skepticism for post-merger adjustments to management projections or the creation of new projections entirely.

²²² *MacLane Gas Co L.P V Enserch Corporation* C.A No. 10760 (Del. Ch. Aug 18 1992 revised Dec 9, 1992)

²²³ *Gilbert V M.P.M Enters Inc supra*

²²⁴ *Hintmann V Fred Weber Incorporation* C.A No 12839 (Del. Ch. Feb 17, 1998), slip op at 8; *Cede & co V Technicolor Incorporation* C.A No 18648 (Del. Ch. Feb. 10 2004) slip op at 11

petition relating to appraisal remedy, used the valuation methods above as are relevant to the fact in issue. The court has not shied away from applying the most accurate and effective method in petitions. In essence, the court had always applied the most suitable method and not given one method exclusive application over the others. This is a welcome development as it allowed for the most efficient and fairest method to be applied.

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6.1 CONCLUSION

In this study, the appraisal right remedy, as guaranteed by the South African Companies Act No 71, 2008, has been examined pointing out its efficacy to the minority shareholders and the procedure to follow in making use of the remedy. This study has been able to show that the introduction of the remedy in South Africa is commendable as it enables the shareholder exit the company as of right and with less rigour, as against the practise associated with other remedies following the court process. The use of the remedy involves less of the court and makes the exit of the shareholder from the company less difficult.

Though the remedy is with stringent procedure and observation of duration, it has come in handy in safeguarding the interest of the shareholder. The remedy at times, when activated, serves as a check to the oppressiveness of the majority shareholders. The prospect of paying huge amount as fair value deters the majority from implementing the proposed idea. However, the remedy is only triggered in instances of fundamental transaction and alteration of rights as guaranteed in the memorandum of the company. This makes it unusable in situations outside the triggering events. In such instances other forms of remedy are employed to protect the interest of the shareholder in the company.

Central to the appraisal right is the determination of the fair value of the shares of the shareholder. Although the enabling Act failed to specify the manner of determining the fair value of the shares, this study has been able to identify various methods in which the shares of the company can be calculated and determined. While comparing the use of the remedy in South Africa with the use of the remedy in Delaware, United States; various methods already used in Delaware were identified. The methods identified are sufficient to give a fair value of the shares in the remedy based on the manner of company involved. Of recent, the method of Discounted Cash Flow (DCF), which treats the company as a going concern and provides more reliable value for the shares, is used readily.

6.2 RECOMMENDATION

The Appraisal right, as examined, is a commendable innovation in the South African Companies Act. The remedy grants the minority shareholder the exit needed from the company and the majority shareholder in the event of a fundamental transaction. This in effect frees the minority from been locked in the company as was the order under the old Act. Though with criticism, the remedy is a welcome development in the corporate law of South Africa.

In regard to the practise of the remedy, the Delaware Jurisdiction has a better procedural application than the South African jurisdiction. It is advised that the South African jurisdiction should learn from the Delaware jurisdiction in adopting a simplified approach to the interpretation of the application in court. The time-frame as well as adherence to the procedure should not be rigid in interpretation, but flexible. This would ease the rigidity and complexity of the procedure on the minority shareholder. Also, the means of instituting the application in court should be made less burdensome. The minority shareholder should be enabled to apply to the court for protection, as against the fear of any backlash of event.

In determining the value of shares of a company, in South Africa, the company and the court should adopt the most accurate method of valuation. One method should not be made exclusive to the other. The method of calculation to be used should be dictated by the nature of the company and the circumstance in question.

Understandably, the valuation of shares is not a simplified calculation as it involves rigorous calculation. I submit that the use of experts should be welcomed and extensively employed. This would guarantee an accurate and more reliable result.

In a Delaware case, the court stated that:

The basic concept of the value under the appraisal statute is that the stockholder is entitled to be paid for that which has been taken from him, viz his proportionate interest in a going concern. By value of the stockholder's proportionate interest in the corporate enterprise is meant the true intrinsic value of his stock which has been taken by the merger. In determining what figure represents this true or intrinsic value, the appraiser and the courts must take into consideration all

factors and elements which reasonably might enter into the fixing of value. This, market value, asset value, dividends, earnings prospects, the nature of the enterprise and any other facts which were known or which throw any light on the future prospects of the merged corporation are not only pertinent to an inquiry as to the value of the dissenting stockholders' interest, but must be considered by the agency fixing the value.²²⁵

I submit and align with this ruling of the court. The company and the court, in determining the value of shares of the company, should take into consideration all relevant facts that would yield an accurate value and serve the purpose of justice.

²²⁵ Tri-continental Corporation V Battye 74 A. 2d 71 (Del. 1950)

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