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TABLE OF CONTENTS

Introduction

Excitement surrounding hostile takeovers has been renewed in light of the attempted takeover of Adcock Ingram, by Bidvest.[1] The plot thickened when the bid was challenged by CFR Pharmaceuticals.[2] It seems as if Adcock successfully warded off the hostile takeover by Bidvest, thereby continuing the tendency of hostile takeovers to fail in South Africa.[3]

The above has drawn attention to the ability of a target company to take frustrating action to defend against a hostile takeover bid and the extent to which the takeover provisions in the Companies Act 71 of 2008 ('the 2008 Act') and its Regulations provide the room to do so.[4] I will argue that, in the spirit of the Act, which replaced the Companies Act 61 of 1973 ('the 1973 Act'), the takeover provisions should have the inherent flexibility to allow the directors and/or shareholders to take frustrating action.[5] This has long been a controversial area of Company law in many jurisdictions.[6]

The 2008 Act came into effect on 1 May 2011.[7] The takeover regime remains largely unchanged.[8] When using the term 'takeover' one refers not to the transactions but

[1] *http://www.fiercepharma.com/press-releases/adcock-ingram-holdings-limited-notice-receipt-unsolicited-letter-bidvest-gr; http://www.adcock.co.za/Investors_SENS_Full.aspx?id=259; http://www.bdlive.co.za/business/healthcare/2013/07/18/pic-worried-cfrs-offer-for-adcock-may-be-poor-deal; http://www.bdlive.co.za/business/healthcare/2013/04/08/bidvest-to-pull-out-all-stops-for-adcock* (last accessed 14 September 2013).

[2] *http://www.bdlive.co.za/business/healthcare/2013/05/09/bidvest-may-have-rival-bidder-for-adcock-ingram; http://www.moneyweb.co.za/moneyweb-industrials/cfr-pharmaceuticals-offers-adcock-ingram-r7351-per* (last accessed 14 September 2013).

[3] *http://www.bdlive.co.za/business/healthcare/2013/07/07/financial-services-board-quizzes-bidvest-after-suspicious-adcock-trades-tip-off; http://www.bdlive.co.za/business/healthcare/2013/04/08/bidvest-to-pull-out-all-stops-for-adcock* (last accessed 14 September 2013); Philip Sutherland 'Shareholder Democracy in South Africa?' in M. Olaerts & C.A. Schwarz *Shareholder Democracy: An Analysis of Shareholder Involvement in Corporate Policies'* (2012) 79 at 96.

[4] *www.bdlive.co.za/business/healthcare/2013/04/08/bidvest-to-pull-out-all-stops* (last accessed 14 September 2013).

[5] See generally, Jared Nickig 'Hat's Off, Gentlemen (and Ladies), to One of Your Greatest Generals' (July 2011) *Without Prejudice: Company International Law* 22.

[6] Darryl Levitt and Katherine Bee 'Surviving the Hostile Bid' (January/ February 2009) 2 *Inside Mining* 40 at 41.

[7] Piet Delport *Henochsberg on the Companies Act 71 of 2008* (Service 1, 2011) preface.

rather to the effect of those transactions where they have resulted in a change of control.[9]

I will rely on the regime in the United States ('the US'), particularly Delaware, where over half of the companies in the United States are incorporated.[10] Delaware has a court run regime which allows much flexibility and allows for the natural development of the law, as opposed to hard and fast rules.[11] I will also have regard to the regime in the United Kingdom ('the UK'), given that our system is largely based thereon.[12] Lastly, I will refer to the takeover regime in Australia, which is considered the 'middle ground' between the UK and the US.[13] Throughout this paper I will bear in mind that the South African economic climate differs from that of its international counterparts.[14] However, South African legislation needs to be such that it fosters economic growth, whilst being sensitive to our political history.[15]

The Paper will consist of five chapters. In the first chapter I will discuss important definitions and the difference between a hostile and a friendly takeover. In the second chapter I will discuss the operation, effect and theories underlying the concept of a

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[8] Ezra Davids, Trevor Norwitz and David Yuill 'A Microscopic Analysis of the New Merger and Amalgamation Provision in the Companies Act 71 of 2008' (2010) *Acta Juridica: Modern Company Law for a Competitive South African Economy* 337 at 337.

[9] ME Matsaneng 'Corporate Control Transactions in South Africa' (2010) *Transactions of the Centre for Business Law: The Role and Consequences of Pure Corporate Control and Corporate Social Responsibility in the Republic South Africa and the United States of America* 75 at 84-85; Maleka Femida Cassim and Jacqueline Yeats 'Fundamental Transactions, Takeovers and Offers' in Farouk HI Cassim, Maleka Femida Cassim, Rehana Cassim et al *Contemporary Company Law* 2ed (2012) 672 at 731; MA Weinberg and MV Blank *Take-overs and Mergers* 4ed (1979) at 3.

[10] Albert O "Chip" Saulsbury, IV 'The Availability of Takeover Defenses and Deal Protection Devices for Anglo-American Target Companies' (2012) *Delaware Journal of Corporate Law* 115 at 118.

[11] See generally, Saulsbury op cit note 10.

[12] *Haslam v Sefalana* 1998 (4) SA 964 (W) at para 975J.

[13] Nigel Boardman 'Critical Analysis of the New South African Takeover Laws as Proposed under the Companies Act 71 of 2008' (2010) *Acta Juridica: Modern Company Law for a Competitive South African Economy* 306 at 332-333.

[14] ME Matsaneng 'The Meaning of Corporate Control' (2010) *Transactions of the Centre for Business Law: The Role and Consequences of Pure Corporate Control and Corporate Social Responsibility in South Africa and the United States of America* 10 at 29.

[15] Davids, Norwitz and Yuill op cit note 8 at 338.

hostile takeover. The third chapter will set out the Regulatory Regime of frustrating action in South Africa which consists of the Companies Act containing the Takeover Regulations and establishing a Takeover Regulation Panel ('the TRP').[16] The fourth chapter analyses who should make the decision to take a frustrating action to thwart a hostile takeover.[17] The fifth chapter will consider the takeover regimes in the UK, the US and Australia in order to compare them to that of South Africa in order to determine how best to apply or amend our current regime. Finally, I will consider how appropriate hostile takeovers are in the South African context and how a company can defend against it. I will argue that absolute power should not lie with the shareholders and that a more flexible approach is necessary.

[16] The TRP is regulated in terms of Part C of Chapter 8.
[17] Nickig op cit note 5 at 23.

Chapter 1: Preliminary Definitions

In this chapter I will discuss the definition of 'takeover' and the difference between that and a 'takeover bid'.[18] Closely connected to this is the definition of 'control'.[19] Lastly, I will discuss the difference between a hostile and a friendly takeover.[20]

Definition of a Takeover

Takeovers focus on the effect that a transaction has and whether it results in the acquisition, consolidation or change of control.[21] A 'takeover' occurs when an individual or a company, through a transaction, acquires control (or takes over) the assets or management of another company whereas a 'takeover bid' is a means of carrying out a takeover.[22] The aim is to utilize it to enable the acquirer to obtain sufficient shares in the company to enable him to exercise voting control.[23]

Definition of Control

The definition of 'control' is similar to that under the previous regime.[24] Under the 1973 Act it was defined as:

> a holding or aggregate holding of shares or other securities in a company entitling the holder thereof to exercise, or cause to be exercised, directly or indirectly, the specified percentage or more of the voting rights at meetings of that company or any company

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[18] Weinberg and Blank op cit note 9 at 3.
[19] Regulation 81(e).
[20] Carl Stein with Geoff Everingham *The New Companies Act Unlocked* (2011) 338.
[21] Matsaneng op cit note 9 at 84-85; Cassim and Yeats op cit note 9 at 731.
[22] Weinberg and Blank op cit note 9 at 3.
[23] Ibid at 4.
[24] Stein op cit note 20 at 324.

> controlled by it, irrespective of whether such holding or holdings confer de facto control. [25]

The definition in the Regulations is similar but marginally wider.[26] It provides that 'control' means 'the holding of a beneficial interest in a regulated company equal to or exceeding the specified percentage of voting rights in that regulated company'.[27] The definition is wider as 'beneficial interest'[28] encapsulates not only voting rights but also the right to participate in distribution and to dispose of any part of a security.[29] The specified percentage referred to above may be set by the Minister of Trade and Industry and may not exceed 35 per cent.[30] It is currently set at 35 per cent.[31]

It is averred that the prescribed percentage was set at 35 per cent to cater for broad-based black economic empowerment (hereinafter referred to as 'BBBEE') consortiums as they generally own one third of companies, and the 35 per cent threshold ensures that the mandatory offer is not triggered.[32] A mandatory offer is triggered where a person or persons acting in concert, after an acquisition, can exercise more than the prescribed voting securities in the target company.[33] That person or persons must offer to acquire the remainder of the securities of that company on the same terms.[34] Mandatory offers are triggered at 30 per cent in the UK.[35] The concept of a mandatory offer does not exist in the US and Australia.[36]

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[25] Section 440A(1).
[26] The Companies Regulations, 2011 were published on 26 April 2011 GN R.351, GG 34239. Section 120 provides that the Minister is to publish regulations to give effect to part B and part C of the Act, these are the Takeover Regulations.
[27] Regulation 81(e).
[28] Section 1.
[29] Companies Act 61 of 1973 s440A(1); Companies Act 71 of 2008 s1.
[30] Section 123(5) read with reg 86(1).
[31] Ibid.
[32] Boardman op cit note 13 at 324.
[33] Section 123(2).
[34] Section 123(4).
[35] Boardman op cit note 13 at 324.
[36] Ibid; RP Austin and IM Ramsay 'Ford's Principle of Corporations Law' 15ed (2013) 1358.

There has been criticism that the 35 per cent threshold hampers the advancement of previously disadvantaged persons.[37] It is simply too costly for BBBEE constituencies to acquire majority control in companies by exceeding the 35 per cent threshold and thus triggering the mandatory offer.[38] There have been submissions that legislation should take heed of this and exempt BBBEE consortiums from compliance with takeover laws.[39] The threshold becomes more of a concern when one considers that a certain entity may be part of a consortium of BBBEE companies and that when one of the entities in the consortium makes an offer it would qualify as 'acting in concert' and as a result each entity in the consortium will be forced to make a mandatory offer.[40]

Previously, the mandatory offer would be triggered, not only when the 35 per cent was reached but also at increments of 5 per cent up to 50 per cent,[41] in other words, if a person with 35 per cent went from 35 per cent to 40 per cent, 40 per cent to 45 per cent or 45 per cent to 50 per cent it would trigger the mandatory offer but not if the offeror has more than 50 per cent.[42] This was referred to as the 'creep provisions' under the 1973 Act and has since been abolished.[43]

The Difference between Hostile and Friendly Takeovers

The Takeover Regulations do not explicitly provide for two types of takeovers, but it is evident from the provisions that there are two types of takeovers that can take place, namely, a friendly and a hostile takeover. [44]

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[37] Mpheane Abiot Lepaku 'Mandatory Offer and BEE' (2005) 13 *The Quarterly Law Review for People in Business* 170 at 171.
[38] Ibid.
[39] Ibid at 171-172.
[40] Ibid.
[41] Securities Regulation Code on Takeovers and Mergers Rule 8.1.
[42] Lepaku op cit note 37 at 171.
[43] Stein op cit note 20 at 23; Boardman op cit note 13 at 323.
[44] Stein op cit note 20 at 338.

A friendly takeover can also be referred to as a negotiated takeover.[45] It is where the acquirer has approached the board of the target company prior to making the formal bid to the shareholders of the said company.[46] The board then agrees to the offer made by the acquirer and either recommends it to the shareholders or remains neutral.[47] In practice this occurs by the acquirer and the target board jointly communicating with the target shareholders by issuing combined circulars.[48]

A hostile takeover can also be referred to as an un-negotiated takeover.[49] This is where the acquirer has approached the target board, the board opposes the bid and advises the shareholders to reject the offer.[50] Despite this, the acquirer seeks to takeover the company on the terms and conditions rejected by the target board or the acquirer bypasses the target board (not seeking their approval at all)[51] and makes a bid directly to the shareholders of the target company.[52] For this reason hostile takeovers have been described as 'legally graceless'.[53] In practice they usually occur by means of the acquirer and the target board communicating separately with the target shareholders, and if necessary, the shareholders of the acquiring company.[54]

The board may be opposing the offer with the intention of genuinely defending against the takeover as they believe it not to be in the best interests of the company and its shareholders.[55] However, the board may simply be rejecting it with the sole purpose of

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[45] Matsaneng op cit note 9 at 88.
[46] Levitt and Bee op cit note 6 at 41.
[47] Weinberg and Blank op cit note 9 at 7.
[48] Stein op cit note 20 at 338.
[49] Matsaneng op cit note 9 at 87.
[50] Weinberg and Blank op cit note 9 at 7.
[51] Matsaneng op cit note 9 at 87.
[52] Levitt and Bee op cit note 6 at 41.
[53] ME Matsaneng 'Corporate Control Transactions in the United States of America' (2010) *Transactions of the Centre for Business Law: The Role and Consequences of Pure Corporate Control and Corporate Social Responsibility in South Africa and the United States* 132 at 145.
[54] Stein op cit note 20 at 338.
[55] Weinberg and Blank op cit note 9 at 8.

negotiating a better price for the shareholders, which is often the case in the US.[56] A 'bidding war' may also arise either on the invitation of the target board or as a result of the offer going public.[57]

Directors and managers tend to oppose these bids because they involve inherent risks.[58] In a hostile bid the acquirer will not be able to undertake a complete due diligence of the target company and as a result financial institutions will be reluctant to finance the takeover bid as the extent of the liabilities of the target company are unknown.[59] Regardless of whether it is a hostile or friendly takeover, for some reason the transaction costs involved in a takeover are often overlooked, including, financing fees, investment advisory fees and legal fees.[60] Hostile takeovers are an especially expensive business, even more so in jurisdictions where the target board can employ defensive mechanisms to ward off a hostile bid.[61] However, when a target board employs these defensive mechanisms it is often to negotiate a better deal for the shareholders of the target board.[62] As a result, a hostile bid may be more beneficial to the shareholders but not to the target company.[63] The rationale for the assertion that defensive mechanisms yield better prices for shareholders is simply that if a first offer by a bidder does not succeed then the second offer will logically have to be higher.[64] In other words, the very fact that shareholders often benefit from management's resistance serves to justify resistance itself.[65]

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[56] Ibid.
[57] Ibid.
[58] Nickig op cit note 5 at 23.
[59] Levitt and Bee op cit note 6 at 41.
[60] Alan R. Palmiter *Corporations: Explanations and Examples* 6ed (2009) 664.
[61] Levitt and Bee op cit note 6 at 41.
[62] Ibid.
[63] Ibid.
[64] Christian Kley *Defensive Tactics Against Takeovers in Theory and Practice in the USA, the UK, South Africa, Germany and the EU* (1999) LLM Dissertation, University of Cape Town at 15.
[65] Ibid.

In a successful takeover a shareholder should receive a premium price for their shares.[66] It therefore seemingly benefits the shareholders but does not take into consideration that during a hostile takeover shareholders are generally pressured to sell their shares.[67] It is averred that hostile takeovers have a negative long term effect on the productivity and returns of the target company.[68] Empirical findings are not convincing in this regard.[69] Part of the reason is due to the various methods which are used to collect and analyse data.[70]

Summary

The definition of 'control' is the key to takeovers as once that change in control occurs it triggers a takeover.[71] It is evident from the discussion above that the decision to undergo a hostile takeover from the acquirer's perspective is risky and the decision to take defensive action on the part of the target company must be well thought out.[72]

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[66] Ibid at 14.
[67] Ibid.
[68] Martin Lipton 'Takeover Bids in the Target's Boardroom' (1979) *Business Lawyer* 101 at 110.
[69] John C. Coates IV 'Takeover Defenses in the Shadow of the Pill: A Critique of the Scientific Evidence' (2000) 79 *Texas Law Review* 271 at 317 as cited by Jordan M. Barry, John William Hatfield 'Pills and Partisans: Understanding Takeover Defenses' (2012) *University of Pennsylvania Law Review* 633 at footnote 6, which deals with empirical findings in the context of using the poison pill. For a discussion of the inconclusive nature of empirical evidence regarding mergers and acquisitions in Nigeria, see Olowoniyi Adeyemi Olusola and Ojenike Joseph O 'Mergers and Performance of Conglomerates Companies in Nigeria' Vol 3 (2012) *Journal of Emerging Trends in Economics and Management Sciences (JETEMS)* 393 at 395. Regarding the uncertainty on the effect on shareholders post hostile takeover, see Simon Deakin 'Corporate Governance, Finance and Growth: Unraveling the Relationship' (2010) *Acta Juridica: Modern Company Law for a Competitive South African Economy* 191 at 201. For varied evidence regarding the effect on profitability, see A Cosh and A Hughes 'Takeovers after "Takeovers" ' CBR Working Paper No 636, June 2008 as cited by Simon Deakin 'Corporate Governance, Finance and Growth: Unraveling the Relationship' (2010) *Acta Juridica: Modern Company Law for A Competitive South African Economy* at footnote 46.
[70] Kley op cit note 64 at 19.
[71] Matsaneng op cit note 9 at 84-85; Cassim and Yeats op cit note 9 at 731; Regulation 81(e).
[72] Weinberg and Blank op cit note 9 at 8; Nickig op cit note 5 at 23; Levitt and Bee op cit note 6 at 41; Palmiter op cit note 60 at 664; Kley op cit note 64 at 14, 15; See, footnote 69.

Chapter 2: The Operation, Effect and Rationale of a Takeover

In this chapter I will discuss how a takeover comes about.[73] I will then explain that a takeover can result in one of three types of acquisitions.[74] It can also be a hybrid but this is unusual.[75] Finally, I will delve into the theories that underlie takeovers, most of which are rooted in law and economics.[76]

Operation of a Takeover

The takeover is usually motivated by a bidder making an offer to acquire a controlling block of shares in another company, referred to as the target company.[77] A bidder is also known as an acquirer or an offeror and is often described as a 'corporate raider' in the US if the offer is a hostile one.[78] If sufficient shareholders 'tender' or accept the offer, the bidder will acquire control of the target company.[79] However, the board of the target company may reject the offer made by the acquirer and a takeover battle may ensue.[80]

Effect of a Takeover

The result of a takeover transaction can be categorized as a horizontal, vertical or conglomerate acquisition.[81] A horizontal acquisition is between companies in the same industry in that they produce the same products or services.[82] This form is most often

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[73] Steven C. Bradford 'Stampeding Shareholders and Other Myths: Target Shareholders and Hostile Tender Offers' (1990) *The Journal of Corporation Law* (1990) 417 at 417; Matsaneng op cit note 53 at 145; Kley op cit note 64 at 1-2.
[74] Weinberg and Blank op cit note 9 at 5; Olusola and Joseph op cit note 69 at 395.
[75] Weinberg and Blank op cit note 9 at 6.
[76] Andreas Cahn and David C. Donald *Comparative Company Law Text and Cases on the Laws Governing Corporations in Germany, the UK and the USA* (2010) 795.
[77] Bradford op cit note 73 at 417.
[78] Ibid; Matsaneng op cit note 53 at 145.
[79] Bradford op cit note 73 at 417; Kley op cit note 64 at 1-2; Matsaneng op cit note 53 at 145.
[80] Kley op cit note 64 at 1-2.
[81] Weinberg and Blank op cit note 9 at 5; Olusola and Joseph op cit note 69 at 395.
[82] Ibid.

used by companies competing with each other.[83] As it reduces competition it may be a cause for concern in the arena of competition law. [84]

A vertical acquisition 'expand[s] backward or forward in the chain of distribution, towards the source of raw materials or towards the ultimate consumers'.[85] In other words, instances where either of the two companies 'is an actual or potential supplier of goods or services to the other, so that the two companies are both engaged in the manufacture or provision of the same goods or services but at different stages in the supply route'.[86] The purpose is to secure either a supply or an outlet for services or products.[87] A conglomerate is between hosts of unrelated companies, in other words, companies in different industries.[88]

Rationale for Takeovers

The dominant theory supporting the takeover mechanism is called the 'efficient capital market theory'.[89] It provides that the share price indicates the sum total value of the company.[90] Ultimately, if a company has a low share price this is equated with bad management and the company is susceptible to a takeover.[91] The possibility of a takeover, on the one hand, serves a monitoring and encouragement function for the board.[92] On the other hand, it may be detrimental, as will be discussed later on.[93]

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[83] Weinberg and Blank op cit note 9 at 5.
[84] Ibid.
[85] Olusola and Joseph op cit note 69 at 395.
[86] Weinberg and Blank op cit note 9 at 5.
[87] Ibid.
[88] Olusola and Joseph op cit note 69 at 395; Weinberg and Blank op cit note 9 at 6.
[89] Frank H Easterbrook and Daniel R Fischel 'The Proper Role of a Target's Management in Responding to a Tender Offer' (1981) *Harvard Law Review* 1161 at 1165.
[90] Ibid.
[91] AL Christison and RC Williams 'The Harmony – Gold Fields Take-over Battle' (2008) 125 *SALJ* 790 at 793.
[92] Kley op cit note 64 at 6.
[93] Ibid at 2.

If a shareholder is dissatisfied with the management of the company, that shareholder may sell his or her shares.[94] When a shareholder does this it may lower the price of the shares and in effect make it easier and more attractive for a potential acquirer to takeover the company.[95] Easier, because an acquirer will then offer a seemingly large sum for the shares and as a result shareholders will be more likely to sell.[96] More attractive, because the acquirer believes that the assets of the company are undervalued as the share price of the target company does not necessarily reflect the true value of the assets of the company.[97] The sum that the acquirer will offer will usually be above the market price of the shares but below what it believes the true value to be.[98]

When a company has a low share price in relation to its potential value, the company is deemed to be underperforming and will then find itself vulnerable to a takeover.[99] The larger the gap the greater the chance of a takeover and the more bidders will be waiting to make a move.[100] The under-performance gives the impression that a company is not being efficiently managed and that the new owners could maximize the value of the company by managing it better if taken over.[101] This is based on the efficient capital market theory which provides that 'the price of a share embodies all of the available information about the value of the shares',[102] and therefore it will be evident in the price of the share if a company is being mismanaged.[103] This theory is based on market efficiency.[104]

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[94] H G Manne 'Mergers and the Market for Corporate Control' (1965) 73 *Journal of Political Economy* 110 at 112-113 as cited by Christison and Williams op cit note 91 at footnote 10.
[95] Ibid.
[96] W. Stewart Robinson 'A Change in the Legal Wind – How a New Direction for Corporate Governance Could Affect Takeover Regulation' (2012) *International Company and Commercial Law Review* 292 at 293.
[97] Weinberg and Blank op cit note 9 at 25; Robinson op cit note 96 at 293.
[98] Weinberg and Blank op cit note 9 at 26-27.
[99] Christison and Williams op cit note 91 at 793.
[100] Ibid.
[101] Matsaneng op cit note 53 at 145.
[102] Easterbrook and Fischel op cit note 89 at 1165.
[103] Kley op cit note 64 at 5-6.
[104] Ibid at 22.

The acquirers could manage it better by removing managers, stripping assets or closing unprofitable business ventures.[105] The right of an acquirer to approach the shareholders and convince them of this is an inherent part of a free enterprise economy.[106] The hope is that the company would increase in value and the acquirer would not only have made a profit but also benefit the community and employees of the target company by maximizing the potential of the business.[107]

The possibility of being taken over serves as encouragement or as incentive to boards to constantly and consistently perform to their full potential.[108] It is thus perceived as a monitoring function.[109] There is a fear on the part of directors because generally managers are ousted when a company is taken over.[110] Theoretically this awareness creates competition which in turn is good for business.[111] The danger of this is that the board may make decisions based on short term financial returns and the current share price in order that shareholders may be satisfied and therefore not vote in favour of a takeover.[112]

The other view is that takeovers are detrimental to the optimum functioning of the economy in its entirety.[113] This perspective focuses on socio-economic considerations such as retrenchment, shutting down of the company, effects on the community as they lose their core employer and the relationships between target companies and their

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[105] JR Wiblin 'A Mandatory Takeover Offer – Too High a Price for the Economy to Pay?' *Journal for Juridical Science* (2004) 173 at 176.
[106] Weinberg and Blank op cit note 9 at 11.
[107] Kley op cit note 64 at 8.
[108] Ibid.
[109] Ibid.
[110] Matsaneng op cit note 53 at 142.
[111] Ibid.
[112] Deakin op cit note 69 at 195; K. Keasey, S. Thompson and M. Wright 'Completing Diagnoses and Solutions' in *Corporate Governance: Economic, Management and Financial Issues (*1997) 5 as cited by Robinson op cit note 96 at footnote 35.
[113] Kley op cit note 64 at 2.

customers and/ or suppliers.[114] One needs to bear in mind that a company in a tight spot may need to implement structural changes in any event in order to save their business.[115] There are also arguments that the threat of a takeover defeats effective long term planning[116] and instead emphasises short term gain.[117] Long term planning is defeated because stakeholders plan to protect themselves in case the company is taken over.[118] These stakeholders include shareholders, employees, customers, suppliers and the community at large.[119]

Summary

The efficient capital market theory provides a well-reasoned rationale for takeovers and it is submitted that it follows naturally that an acquirer would want to takeover a company for less than it is actually worth.[120] This rationale will have an impact on the debate around who should have the power to make decisions regarding frustrating action.[121]

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[114] Ibid at 2, 7.
[115] Ibid at 8.
[116] Ibid at 4.
[117] Ibid at 12.
[118] Lipton op cit note 68 at 110.
[119] Ibid.
[120] This is discussed at 11-14.
[121] This is discussed in Chapter 4.

Chapter 3: Regulatory Regime

In this chapter I will discuss the concept of frustrating action in South Africa. I will explore what it is, when the prohibition is triggered and the role of the TRP in regulating it.

Purpose of Code

The main purpose of changing the takeover regime under the 2008 Act was to undertake an assessment of the role of the Securities Regulation Panel ('the SRP') and to consider the ambit of the terms 'fundamental transaction' and 'affected transaction'.[122]

The 1973 Act established the SRP and it regulated affected transactions through the Securities Regulation Code on Takeovers and Mergers.[123] The Code was based on the City Code on Takeovers and Mergers, ('the UK City Code') which was at the time observed voluntarily and referred to as 'quasi-legal'.[124] Under the 1973 Act the Code did not have legislative status.[125]

The 2008 Act has replaced the SRP with the TRP which is the regulatory institution established in terms of s196(1).[126] Its main purpose is to regulate affected transactions.[127] The takeover provisions are contained in Part B and Part C of Chapter

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[122] Tshepho H Mongalo 'An Overview of Company Law Reform in South Africa: From the Guidelines to the Companies Act 2008' (2010) *Acta Juridica: Modern Company Law for a Competitive South African Economy* 13 at 18.
[123] Stephanie M Luiz 'Enforcement of the Securities Regulation Code and the Role of the Courts' (2006) 27 *Obiter* 49 at 49.
[124] Wiblin op cit note 105 at 177-178.
[125] Dennis Davis, Farouk Cassim, Walter Geach, et al *Companies and Other Business Structures in South Africa* 2 ed (2011) 207.
[126] Ibid.
[127] Ibid.

5 of the Act and in the Takeover Regulations which are in Chapter 5.[128] The Regulations, as issued by the Minister of Trade and Industry, have the status of delegated legislation and is therefore subordinate to the Act.[129] This is a fundamental change as the authority of the SRP was questioned under the old regime because it had no express power provided to it in terms of the 1973 Act.[130]

Section 119(1) sets out the objects of the TRP in regulating affected transactions and s119(2) promotes the objects.[131] These are materially similar to the general principles provided in the SRP Code.[132] The fundamental difference is that the general principles were for purposes of guidance and not legally enforceable.[133] The objects of the Panel is to regulate transactions:

> without regard to the commercial advantages or disadvantages of any transaction or proposed transaction, in order to-
>
> (a) ensure the integrity of the marketplace and fairness to the holders of securities of regulated companies
>
> (b) ensure the provision of-
>
> (i) necessary information to holders of securities of regulated companies, to the extent required to facilitate the making of fair and informed decisions; and
>
> (ii) adequate time for regulated companies and holders of their securities to obtain and provide advice with respect to offers; and

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128 Cassim and Yeats op cit note 9 at 741.
129 Davis, Cassim and Geach op cit note 125 at 207; Christina Pretorius and Isla Swart 'Mandatory Offers' (November 2011) *Without Prejudice* 25 at 25.
130 Davis, Cassim and Geach op cit note 125 at 207; Luiz op cit note 123 at 53.
131 Stein op cit note 20 at 316.
132 Ibid.
133 Ibid.

(c) prevent actions by a regulated company designed to impede, frustrate, or defeat an offer, or the making of fair and informed decisions by the holders of that company's securities.[134]

Section 119(2) provides that the objects must be given effect to by ensuring that security holders of the same class are treated equally and that all relevant information must be provided to them.[135] Practically, it also provides that a person must not enter into an affected transaction unless they can and are intending to implement it.[136]

Scope of the Takeover Regulation Panel

The TRP has jurisdiction over all affected transactions involving 'regulated companies'[137] unless the Panel has granted an exemption.[138] If no exemption is granted, a transaction cannot be implemented unless the Panel has issued a compliance notice.[139] The Panel has jurisdiction where the transaction will result in a change of the holders of the securities.[140] There are no guidelines provided as to how the TRP is to make a decision[141] and the legislature did not make provision for time limits.[142] The only standard that the TRP then has to meet is the objects of the Takeover Regulations.[143]

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134 Section 119(1).
135 Section 119(2)*(b)* and 119(2)*(c)*.
136 Section 119 (2)*(a)*.
137 This is defined at 24.
138 Davis, Cassim and Geach op cit note 125 at 207; Companies Act 71 of 2008 s119(6).
139 Section 121.
140 Stein op cit note 20 at 305.
141 Companies Regulations Part E Reg 116-122; Companies Act Part B Section 117-120. The guidelines used by the Panel in Australia, referred to as Guidance Note 12, is fully discussed at 66.
142 Companies Regulations Part E Reg 116-122; Companies Act Part B Section 117-120. John Armour and David Skeel Jr. 'Who Writes the Rules for the Hostile Takeovers, and Why? The Peculiar Diversions of U.S. and UK Takeover Regulation' (2007) *Georgetown Law Journal* 1727 at 1729, 1744.
143 Section 119.

Frustrating Action

One of the aims of the TRP, as set out in s119, is to regulate transactions or proposed transactions in such a manner that 'prevent(s) actions by a regulated company designed to impede, frustrate, or defeat an offer, or the making of fair and informed decisions by the holders of that company's securities'.[144] The term 'frustrating action' is therefore not expressly defined in the legislation but it finds expression in the objects.[145]

Section 126 was designed to achieve the objective set out in s119.[146] It regulates the actions of the board once an offer is imminent or has been received by the regulated company.[147] In terms of the Act an offer is 'imminent' when a potential offeror has entered into consensual negotiations with a regulated company.[148] An offer is therefore not imminent if it is the subject of rumour or speculation but a firm intention has not been made and if a regulated company has not entered into consensual negotiations with a potential offeror.[149] An offer has been 'received' first when a mandatory offer is required and second when the bidder has communicated a firm intention to make an offer such as a formal written offer[150] and is in fact in a position to proceed.[151] Confidentiality during consensual negotiations is crucial and as a result this is dealt with in reg 94.[152]

Section 126 is therefore only triggered if a company receives a *bona fide* offer or believes such an offer may be imminent.[153] It consists of a 'catch-all'[154] clause and

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[144] Section 119(1)*(c)*.
[145] Section 119.
[146] Stein op cit note 20 at 332.
[147] Ibid.
[148] Regulation 94(1).
[149] Cassim and Yeats op cit note 9 at 743, read with reg 94.
[150] Regulation 101(1); reg 101(3)*(a)*.
[151] Ibid.
[152] Cassim and Yeats op cit note 9 at 743.
[153] Stein op cit note 20 at 332-333; Cassim and Yeats op cit note 9 at 739.
[154] Stein op cit note 20 at 333; Section 126(1)*(a)*.

specific prohibited actions.[155] The 'catch-all' clause provides that once an offer is imminent or has been received, the board of the regulated company may not take any action that could result in a *bona fide* offer being frustrated or the holders of the relevant securities being denied the opportunity to decide that offer on its merits.[156] The board must genuinely believe that there will be an offer and they must have reasonable grounds for this belief.[157]

Even if the frustration provisions did not contain the 'catch-all' phrase, it is submitted that any transaction or agreement which defeated the effect of the frustration provisions would come under scrutiny as it frustrates or denies the holders of securities an opportunity to decide the offer on its merits.[158] This is due to the anti-avoidance provisions found in s6.[159] The provisions in s6 apply generally to all transactions and actions governed by the Act and specifically states that, any transaction or agreement, which results in the effect of a prohibition being reduced or defeated, may be declared void to that extent.[160] Although the section has not yet been interpreted by our courts, any transaction avoiding the outcomes of the Act in the manner described above would be a likely candidate to which the section might apply.[161] The catch-all phrase is however commendable in that it does provide legal certainty.[162]

The duty imposed by the frustration provisions is two-fold.[163] There is the positive duty to inform shareholders of the offer and the negative duty not to frustrate the bid.[164] Flowing from the positive duty to inform shareholders is the fact that directors are

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[155] Section 126 (1)*(a)-(g)*.
[156] Section 126(1)*(a)*.
[157] Delport op cit note 7 at 441.
[158] Stein op cit note 20 at 333; Section 126(1)*(a)*, s6(1) and s119(1)*(c)*.
[159] Section 6.
[160] Section 6(1)*(b)*.
[161] Section 6(1).
[162] Stein op cit note 20 at 333; Saulsbury op cit note 10 at 125; Section 126(1)*(a)*.
[163] Sutherland op cit note 3 at 96.
[164] Ibid.

permitted to offer advice or make recommendations and provide the information on which the recommendation or advice is based.[165] This is to safeguard against shareholders selling their shares at an undervalue.[166] The negative duty not to frustrate a bid flows from the fiduciary duty to act in the best interests of the company.[167] It has been held that it is a breach of this duty to prevent shareholders from deciding on the merits of the offer whether they would like to accept or reject the bid.[168]

In terms of section 126(1) there is a list of actions which the board may not take unless:

1. they have received prior written approval from the TRP and the approval of the relevant security holders; or-
2. the action is in terms of a pre-existing obligation or agreement which was entered into before the board received the offer or before they *bona fide* believed that an offer was imminent. [169]

If the board does however believe that the prospective action is subject to a pre-existing obligation then it may apply to the TRP for consent to proceed with the relevant action.[170] The word 'may' is not peremptory but rather directory and connotes an option on the part of the company to apply to the TRP or not.[171] As a result a company does not have an obligation to apply to the TRP but it is envisaged that a regulated company would instead ere on the side of caution when uncertain of a particular action which is

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165 *Howard Smith v Ampol Petroleum Ltd* 1974 AC 821 (PC) at 837-838; *Samuel v President Brand GM Co Ltd* 1969 (3) SA 629 (A) at 673-674.
166 *Stein v Blake* 1998 (1) All ER 724 (CA) at 729-730.
167 Sutherland op cit note 3 at 97.
168 *Howard Smith* supra note 165 at 835; *Hogg v Cramphorn Ltd* (1967) Ch. 254 Ch D; (1966) 3 W.L.R. 995.
169 Section 126(1).
170 Ibid.
171 Lindi Coetzee 'A Comparative Analysis of the Derivative Litigation Proceedings Under the Companies Act 61 of 1973 and the Companies Act 71 of 2008' (2010) *Acta Juridica: Modern Company Law for a Competitive South African Economy* 290 at 300.

opposed to a listed prohibited action.[172] The list of specific prohibited actions is that the board may not:

(b) issue any authorized but unissued shares;
(c) issue or grant options in respect of any unissued securities;
(d) authorize or issue, or permit the authorization or issue of, any securities carrying rights of conversion into or subscription for other securities;
(e) sell, dispose of or acquire, or agree to sell, dispose of or acquire, assets of a material amount except in the ordinary course of business;
(f) enter into contracts otherwise than in the ordinary course of business; or
(g) make a distribution that is abnormal as to timing and amount.[173]

The provisions are materially similar to that of the UK City Code.[174] In the US, on the other hand, a target board may implement defensive mechanisms during a hostile takeover bid.[175] Australia finds itself somewhat in the middle of these two jurisdictions as frustrating action is not prohibited but it is frowned upon.[176] I will discuss these jurisdictions in greater detail below.[177] Under the old regime, the only defensive action that was permitted in South Africa was the creation of preference stock.[178]

The noteworthy difference between the Code and Regulations is that under the old regime the prohibited action required either shareholder approval or the approval of the SRP, not approval from both.[179] Under the Regulations the type of approval (special resolution or an ordinary resolution) required from the relevant security holders depends

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[172] Cassim and Yeats op cit note 9 at 740.
[173] Section 126(1)*(b)-(g)*.
[174] Boardman op cit note 13 at 332.
[175] Ibid.
[176] Ibid.
[177] This is discussed in Chapter 5.
[178] Kley op cit note 64 at 60.
[179] Stein op cit note 20 at 333; Securities Regulations Panel, Rule 19.

on the type of transaction.[180] This new double approval is consistent with the stated objectives of the Department of Trade and Industry for enhanced transparency.[181] It provides the holders of securities, particularly minority shareholders, with additional protection.[182]

Definition of 'Affected Transaction'

Affected transactions can broadly be categorized into two branches.[183] First, all fundamental transactions are affected transactions if one of the companies is a regulated company.[184] Fundamental transactions are a disposal of all or a greater part of the assets or undertaking,[185] an amalgamation or merger[186] and a scheme of arrangement.[187] The Takeover Regulations will not apply if the transaction is effected in terms of a Business Rescue plan.[188]

Second, the 'acquisition of a prescribed percentage'[189] of voting securities will trigger the takeover provisions.[190] These are for example a mandatory offer and a compulsory acquisition.[191] As previously explained, a mandatory offer is triggered when a person or persons acting in concert, after an acquisition, can exercise more than the prescribed voting securities in the target company.[192] In these instances that person or persons must offer to acquire the remainder of the securities of that company on the same

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180 Delport op cit note 7 at 441; s41.
181 See generally, The Policy Framework for Company Law Reform (2004) cited as 'South African Company Law for the 21st Century: Guidelines for Corporate Law Reform' in GG 26493, vol 468, GN 1183 of 2004; Stein op cit note 20 at 3-4.
182 Boardman op cit note 13 at 312, 333.
183 Davis, Cassim and Geach op cit note 125 at 192.
184 Ibid; s117(1)(c)*(i)-(iii)*.
185 Section 117(1)*(c)(i)*; s112.
186 Section 117(1)*(c)(ii)*; s113.
187 Section 117(1)*(c)(iii)*; s114.
188 Section 118(3).
189 Davis, Cassim and Geach op cit note 125 at 192.
190 Ibid.
191 Section 117(1)*(c)(vi)*; s117(1)*(c)(vii)*; s123; s124.
192 Section 123(2).

terms.[193] A compulsory acquisition occurs where more than 90 per cent of the holders of a certain class of securities, has accepted the offer, and requires the offeror to make an offer to the remaining security holders of that class.[194]

The ambit of the definition of 'affected transaction' has been significantly broadened.[195] In essence it covers more transactions and as a result offers more transparency and protection.[196] It is therefore a considerable improvement.[197] In terms of the 1973 Act, an affected transaction was either a disposal or an acquisition which resulted in a person or persons who did not have control prior to the transaction now possessing such control or a person or persons acting in concert becoming the sole shareholder.[198] This acquisition would then trigger a mandatory offer.[199] It is interesting to note that the provision would also apply to an acquisition or announced intention to acquire a beneficial interest in a regulated company which results in an acquisition or disposal of a beneficial interest of a multiple of 5 per cent, ie 5 per cent, 10 per cent, 15 per cent and so forth.[200]

The purpose of widening the net emanates from the provisions which provide that once a person makes an acquisition or disposal that results in the aforementioned, such person must notify the regulated company, who must in turn notify the TRP and the security holders.[201] Ultimately the provisions necessitate nothing more than regular disclosure to ensure that security holders are aware of the activity of the company and to ensure that the TRP can monitor activity as well so as to ensure that no takeover is

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193 Section 123(4).
194 Section 124(1).
195 Basil Mashabane 'Mergers and Takeovers under the New Companies Act' (September 2011 *De Rebus - SA Attorneys' Journal* at 31.
196 Ibid.
197 Stein op cit note 20 at 313.
198 Section 440A(1).
199 The Code Rule 8.1.
200 Section 117(1)*(c)(iv)* read with s122(1).
201 Section 122(1) read with s122(3); Mashabane op cit note 195 at 31.

effected unnoticed.[202] As previously mentioned, the 'creep provisions' have been abolished.[203]

Affected transactions are used as tools to attain corporate control.[204] Companies thrive off this market and without it cannot function optimally.[205] The market for corporate control finds expression primarily via hostile takeover bids.[206] The concept of 'the market for corporate control' is referring to the contest between the managers or boards of companies and potential bidders competing for the position of managing the resources of a company.[207] This is often the case where the current resources of the company are not being used to their full potential.[208] In an active market there is likely be a contest for this company's resources.[209]

Definition of 'Regulated Company'

As mentioned, the transactions are only considered to be 'affected transactions' where they involve so-called regulated companies.[210] A regulated company is in turn defined as all public and state-owned companies unless the latter has been exempted in terms of the Act, and private companies in limited instances.[211] Private companies are included in terms of the Regulations if more than 10 per cent of the private company's shares have been transferred to unrelated persons during the 24 months preceding the transaction or offer.[212] A private company is also treated as a 'regulated company' on a

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[202] Mashabane op cit note 195 at 31.
[203] Stein op cit note 20 at 23.
[204] Matsaneng op cit note 9 at 75.
[205] ME Matsaneng 'South Africa on Corporate Control: Pure Corporate Control in South Africa' (2010) *Transactions of the Centre for Business Law: The Role and Consequences of Pure Corporate Control and Corporate Social Responsibility in the Republic South Africa and the United States of America* 31 at 31.
[206] Deakin op cit note 69 at 194.
[207] Barry and Hatfield op cit note 69 at 640.
[208] Davis, Cassim and Geach op cit note 125 at 21.
[209] Ibid.
[210] Ibid at 192; s117(1)*(c)*.
[211] Section 118(1).
[212] Section 118(1)*(c)*.

voluntary basis in cases where the Memorandum of Incorporation of the company expressly provides for the application of the Takeover Regulations and parts B and C of the Act.[213] The 1973 Act similarly applied to public companies, state-owned companies and private companies.[214] Private companies had to have a certain number of beneficial shareholders and their interest had to be above a prescribed amount.[215] The possibility existed for private companies to be excluded.[216]

The Relationship between the Companies Act and the Competition Act[217]

The Competition Act[218] regulates takeovers when a transaction is over a certain size and if it poses a threat to competition in the relevant market.[219] The Competition Act and the Companies Act have diverging interests in that competition law is concerned with the 'promotion and protection of competition between firms'[220] and company law is concerned with the best interests of the company, including the interests of minority shareholders and the mechanism to ensure a transparent and procedurally sound transaction process.[221] I will not deal exhaustively with the Competition Act as this falls outside the scope of this paper.

Summary

The regulation of the frustration provisions in legislation provides for legal certainty.[222] There is increased protection as the definition of 'affected transaction' has been widened.[223] The prohibition is stricter under the new regime as there is a double

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[213] Section 118(1)*(c)(ii)*. The Minister prescribed the percentage of 10 per cent in terms of reg91.
[214] HS Cilliers, ML Benade, JJ Henning et al *Corporate Law* 3 ed (2000) 463; The Code section A para 3.
[215] Ibid.
[216] Ibid.
[217] Christison and Williams op cit note 91 at 791.
[218] Competition Act 89 of 1998.
[219] Christison and Williams op cit note 91 at 791.
[220] Ibid.
[221] Ibid.
[222] Saulsbury op cit note 10 at 125.
[223] Mashabane op cit note 195 at 31.

approval required in order for the board to be able to take frustrating action.[224] The threshold of approval by security holders is dependent on the type of transaction.[225] There is no express definition of 'frustrating action' in the Act or Regulations.[226] It is submitted that the regime may have benefited from a definition as it provides further certainty.[227] There are no guidelines for the TRP to follow in order to make a decision and there is also no time limit within which the TRP has to operate.[228] It is submitted that this is a grave oversight on the part of the legislature as the failure to provide guidelines gives the TRP too wide a discretion and the failure to provide time limits means there is no mechanism to deal with delays.[229]

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[224] Stein op cit note 20 at 333; Securities Regulations Panel, rule 19.
[225] Delport op cit note 7 at 441.
[226] As mentioned at 18.
[227] Saulsbury op cit note 10 at 125.
[228] Companies Regulations Part E reg 116-122; Companies Act Part B s117-120.
[229] Leo E Strine, Jr. 'Delaware's Corporate-Law System: Is Corporate America Buying an Exquisite Jewel or a Diamond in the Rough? A Response to Kahan & Kamar's Price Discrimination in the Market for Corporate Law' 86 (2001) *Cornell Law Review* 1257 at 1263 as cited by Saulsbury op cit note 10 at footnote 89; Companies Regulations Part E Reg 116-122; Companies Act Part B Section 117-120; Armour and Skeel op cit note 142 at 1729, 1744; GN12.

Chapter 4: Who Should Make the Decision to Take Frustrating Action?

The purpose of this chapter is to discuss which company organ is better placed to make a decision regarding frustrating action.[230] There is some debate around which company organ is best equipped.[231] The decision to take frustrating action can either be taken by the board or by relevant security holders.[232] I will discuss the diverging views and its rationale.[233]

The shareholder primacy model ascribed to may impact how the board makes this decision.[234] It determines what factors the board takes into account when making decisions and how this will affect whether the board is best set to make a decision.[235] Shareholder activism and the different types of shareholders also play a role in this debate as it explores how involved a shareholder is in the company.[236] It will also be shown that there are different types of shareholders and that depending on the type the shareholder will either have tendency to be active or apathetic.[237] At the end of the chapter I will discuss the South African position regarding matters mentioned above.

Diverging Views

Shareholders exercise indirect control over a company by exercising their voting power through their shares, which makes them the owners of the company.[238] Directors are

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[230] Nickig op cit note 5 at 23.
[231] Ibid.
[232] Ibid.
[233] Ibid.
[234] Sutherland op cit note 3 at 88; Rehana Cassim 'Corporate Governance' in Farouk HI Cassim, Maleka Femida Cassim, Rehana Cassim et al *Contemporary Company Law* 2ed (2012) 472 at 496; Farouk HI Cassim 'Introduction to the New Companies Act: General Overview of the Act' in Farouk HI Cassim, Maleka Femida Cassim, Rehana Cassim et al *Contemporary Company Law* 2ed (2012) 1 at 20; Jean Jacques du Plessis, James McConvill and Mirko Bagaric *Principles of Contemporary Corporate Governance* (2005) 37.
[235] Sutherland op cit note 3 at 88; R Cassim op cit note 234 at 496; F Cassim op cit note 234 at 20; du Plessis, McConvill and Bagaric op cit note 234 at 37.
[236] Sutherland op cit note 3 at 79.
[237] This is discussed fully below.
[238] Matsaneng op cit note 205 at 37, 321.

directly in control of a company as its managers.[239] There are two schools of thought in the US regarding the debate around who should make a decision to take frustrating action to defend against a hostile takeover.[240] The two proponents of these schools of thought are Martin Lipton and Joseph Flom.[241] Lipton was concerned with the interests of the directors.[242] He was the creator of the poison pill, which is the most widely used defensive mechanism in the US.[243] Flom was pro-shareholder and thus believed that the decision to take defensive action should lay with the shareholders.[244]

Rationale Why Shareholder Should Decide

Historically, in South Africa, shareholders decide whether any action can be taken to frustrate a hostile takeover.[245] The rationale is that the shareholders should be able to make a decision as owners of the company regarding their shares and the future of the company therefore the board should not take from them the opportunity to make a decision.[246] Also, as owners, they are entitled to make decisions that are in their best interests, and not necessarily in the best interests of the company.[247] Generally, shareholders look to maximize the value of their shareholding with reasonable risk-taking.[248] This is similar to the position in the UK where the shareholders ultimately decide.[249] The legislation provides that the board must not usurp the discretion of the shareholders as owners to decide whether or not to seize an opportunity.[250] This

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239 Matsaneng op cit note 14 at 17.
240 Nickig op cit note 5 at 23.
241 Ibid.
242 Ibid.
243 Saulsbury op cit note 10 at 138.
244 Nickig op cit note 5 at 23.
245 Securities Regulation Code on Takeovers and Mergers General Principle 2.7.
246 Richard Godden 'Implementation of the European Takeover Directive in the United Kingdom' in Paul Van Hooghten (ed) *The European Takeover Directive and its Implementation* (2009) 743 at 744.
247 Matsaneng op cit note 205 at 33.
248 Weinberg and Blank op cit note 9 at 17.
249 As is discussed in Part I of Chapter 5. UK Takeover Code general principle 3 at B1, rule 21.1(a) at I13.
250 Takeover Code, General Principle 3 at B1.

buttresses the fundamental principle that the shares of listed companies should be freely transferable.[251]

The main argument against allowing directors to decide is that there is the potential of a conflict of interest.[252] Directors are cautious about hostile takeovers as their jobs could literally depend on them defeating the takeover, and so they often desperately seek to entrench themselves.[253] For this reason there is a fear that the board may not act in the best interests of the shareholders and they may reject an offer because they look to entrench their positions.[254] They may also accept an offer either because they want to remain on the board under the acquirer, or due to the fact that a considerable severance package or 'golden handshake' might be on offer should they co-operate with the bidder.[255] These 'golden handshakes' or 'golden parachutes' could be in the form of, for example, share options or severance packages.[256] The issue of entrenchment may become more problematic where directors own shares in the company.[257] The directors must however act only in the best interests of the company and must not have regard to their personal shareholdings.[258]

Rationale Why Board Should Decide

In the US the board has a wide discretion when responding to a hostile takeover bid. [259] Despite the fact that the decision whether or not to accept the actual offer lies with the shareholders, the board has the power to implement a wide range of defensive

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[251] PL Davies *Gower and Davies' Principles of Modern Company Law* (2008) 962.
[252] Levitt and Bee op cit note 6 at 41; Cahn and Donald op cit note 76 at 800; Weinberg and Blank op cit note 9 at 18; Sutherland op cit note 3 at 90-91.
[253] Cahn and Donald op cit note 76 at 800.
[254] Levitt and Bee op cit note 6 at 41.
[255] Weinberg and Blank op cit note 9 at 18; Sutherland op cit note 3 at 90-91; Lucky Phakeng 'M&A Slang: Terms and Phrases' (2009) *Management Today* 52 at 53.
[256] Phakeng op cit note 255 at 53.
[257] Weinberg and Blank op cit note 9 at 575.
[258] Ibid at 576.
[259] Davids, Norwitz and Yuill op cit note 8 at 339.

mechanisms that will frustrate a bid. [260] The rationale is that the board manages the company and as such they are in a better position than the shareholders to make a decision on the merits of the offer.[261] Directors are familiar with the business and have access to all the relevant information.[262] As shareholders are not as knowledgeable it may in fact be to their disadvantage to allow them to make a final decision.[263] It follows that the board can then protect the company (and as a result the shareholders).[264] This is clearly a 'board centric' approach in comparison to South Africa which is more 'shareholder-centric'.[265] The ultimate decision lies with the shareholder and the board lacks any real power to respond to a takeover bid.[266]

It can be worrisome to a board being threatened with a hostile takeover to accept that shareholders do not owe a fiduciary duty to the company therefore unlike the directors they do not have to act in the best interests of the company.[267] As they own shares they are free to exercise the rights in terms of those shares as they so please.[268] This is understandable as shareholders are investors in the company and as such should not be saddled with fiduciary duties[269]. There are exceptions in this regard, that is, directors who are shareholders, the role of majority shareholders to protect the minority and shareholders in small companies like partnerships who owe one another a duty of good faith.[270]

[260] Ibid.
[261] *Aronson v Lewis*, 473 A.2d 805 (Del. 1984) at 811; Boardman op cit note 13 at 333.
[262] Ibid.
[263] Boardman op cit note 13 at 333.
[264] Ibid.
[265] Davids, Norwitz and Yuill op cit note 8 at 339.
[266] Ibid.
[267] Sutherland op cit note 3 at 91.
[268] Ibid.
[269] Ibid.
[270] Ibid; MS Blackman, RD Jooste and GK Everingham *Commentary on the Companies Act* (2002) (revision service 3, 2006) 7-56.

The main issue with shareholders making the decision regarding defensive action is that shareholders have differing interests.[271] Also, shares change hands all the time.[272] A study which reflects this revealed that the holding period of shares have decreased significantly over the last 50 years from an average of six to eight years to between seven months and one year.[273] On top of this, short-term and long-term shareholders have different 'economic incentives'.[274] In light of this it becomes even more crucial for directors when fulfilling their fiduciary duties to act in accordance with what is in the best interests of the company in its entirety and not necessarily what will yield the highest returns for shareholders.[275]

Shareholder Primacy

How much importance a director places on the interest of shareholders will depend by and large on the approach which a specific jurisdiction subscribes to.[276]

The UK the enlightened shareholder value approach.[277] This approach acknowledges that a company has many stakeholders but that their interests are subordinate to those of the shareholders and only when it is in the best interests of the company should the interests of the other stakeholders be considered.[278] Therefore when there is a conflict of interest the shareholders interests should prevail.[279] The concept of 'corporate constituency' is practiced within US takeover law; this is where stakeholder interests are

[271] Jerry Schuitema 'Shareholder Delusions of Grandeur' (May 2012) *Personal Finance Newsletter* 13 at 14.
[272] King II Report on Corporate Governance Principle 17.3.
[273] I. King 'Buyout Leaves a Bad Taste' (1 September 2010) *The Times*, as cited by Robinson op cit note 96 at footnote 8. The study was done on the Stock Exchange in London and New York therefore it applies to listed companies.
[274] Thomas E Holber 'Full of Hot Air? Evaluating the Air Gas Court's Reservations about Shareholders' Short-Term and Long-Term Interests in Takeovers' (2012) *Fordham Journal of Corporate and Financial Law* 123 at 125.
[275] King II Report on Corporate Governance Principle 17.3.
[276] Sutherland op cit note 3 at 88; R Cassim op cit note 234 at 496; F Cassim op cit note 234 at 20; du Plessis, McConvill and Bagaric op cit note 234 at 37.
[277] Sutherland op cit note 3 at 88.
[278] R Cassim op cit note 234 at 496.
[279] F Cassim op cit note 234 at 20.

considered.[280] Therefore constituencies other than shareholders such as employees, suppliers, customers and the community within which the business operates are taken into account when making a decision.[281] In South Africa, King III emphasizes a stakeholder-inclusive approach.[282] This recognizes that a company has many stakeholders which influence it and that when making decisions the board should take into consideration the legitimate interests and expectations of all of its stakeholders and balance these in the best interests of the company.[283]

The difference is that under the enlightened shareholder value approach stakeholders are only considered insofar as it is in the interests of the shareholders to do so. The stakeholder-inclusive approach includes other stakeholders. Their interests are not purely instrumental but rather the interests of all stakeholders, including shareholders, are considered insofar as it is in the best interests of the company as a whole to do so.[284]

It warrants mention that the 'best interests of a company' is not defined in the Act therefore the definition developed by the common law will arguably still apply.[285] The word 'company' in this context therefore applies to shareholders as a collective.[286] There are indications that the legislature is pro-stakeholder, however, King III does not mean that South African law has conclusively embraced this approach.[287]

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[280] du Plessis, McConvill and Bagaric op cit note 234 at 37.
[281] Ibid.
[282] King III Report on Corporate Governance Principle 8.1.1.
[283] Ibid.
[284] R Cassim op cit note 234 at 496.
[285] Farouk HI Cassim 'The Duties and Liabilities of Diectors' in Farouk HI Cassim, Maleka Femida Cassim, Rehana Cassim et al *Contemporary Company Law* 2ed (2012) 505 at 515.
[286] Ibid.
[287] Ibid at 521.

Shareholder Activism

Shareholders as the owners of the company by their very nature take significant risks by investing in the company.[288] However, this may only be the case for the individual shareholders who are blockholders and who are keen activists.[289] A blockholder refers to a shareholder that owns a controlling block of shares.[290] Traditionally, shareholders would have held shares in one company only and they would look after those shares.[291] In modern company law this is not the case, shareholders now have diverse shareholdings.[292] Private shareholders are generally less wealthy and less involved in the affairs of the company but are instead advised by the press.[293] It is difficult to encourage shareholders, with minority holdings, that lack sufficient economic incentives, to exert resources monitoring management and participating meaningfully in voting by, for example, researching the performance of the members of the board and so forth.[294] They become apathetic thereby relinquishing control of the company to the board.[295]

Institutional Shareholders

Institutional shareholders are represented by pension funds, insurance companies, unit trusts, mutual funds and investment management companies.[296] They invest large amounts of public savings in various portfolios' spread over many investments that are managed by portfolio managers.[297] There has been a steady increase of institutional shareholders over the past few decades.[298] In South Africa, most shareholders are now

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[288] Schuitema op cit note 271 at 14.
[289] Ibid.
[290] Geof Stapledon 'The Development of Corporate Governance in Australia' in Christine A. Mallin *Handbook on International Corporate Governance: Country Analyses, Second Edition* 2 ed (2011) 330 at 333.
[291] Robinson op cit note 96 at 295.
[292] Ibid.
[293] Weinberg and Blank op cit note 9 at 16.
[294] Cahn and Donald op cit note 76 at 798; Christison and Williams op cit note 91 at 792.
[295] Cahn and Donald op cit note 76 at 798.
[296] Schuitema op cit note 271 at 14; Weinberg and Blank op cit note 9 at 16; Christine A. Mallin (ed) 'Corporate Governance Developments in the UK' in Christine A. Mallin *Handbook on International Corporate Governance: Country Analyses, Second Edition* 2 ed (2011) 3 at 9.
[297] Weinberg and Blank op cit note 9 at 16; Holber op cit note 274 at 125.
[298] Deakin op cit note 69 at 198; Robinson op cit note 96 at 295.

institutional.[299] The same applies in the UK.[300] As will be discussed below, Australia mainly has blockholders.[301] In the US more than half of the stocks are owned by institutional shareholders.[302]

Institutional shareholders now even have various industry bodies that issue guidelines regarding corporate governance issues.[303] For example, the Institutional Shareholders' Committee has been established in the UK and issued a Code on the Responsibilities of Institutional Investors.[304] In South Africa, the King III Committee recommended that a Code be drafted; in 2011 it came to fruition in the form of the Code for Responsible Investing in South African ('CRISA').[305]

The purpose of an institutional investor is to get the maximum value for its shareholders in the least time possible.[306] The purpose of an institutional shareholder is therefore diametrically opposed to the role of a traditional shareholder; they are investors and by their very nature they need to secure the best return on an investment for the benefit of their beneficiaries.[307] Their motives are purely financially driven.[308] However, institutional shareholder interests are not monolithic as one may presume.[309] They have

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299 Matsaneng op cit note 205 at 46.
300 Mallin op cit note 296 at 9. According to a study by the Office of National Statistics institutional shareholders own approximately 40 per cent of UK equity.
301 Stapledon op cit note 290 at 334.
302 Jennifer E Bethel, Gang Hu and Qinghai Wang 'The Market for Shareholder Voting Rights around Mergers and Acquisitions: Evidence from Institutional Daily Trading and Voting' (2009) *Corporate Finance* 129 at 129 as cited by Holber op cit note 274 at footnote 167.
303 Dan D. Prentice 'Shareholder Democracy: Takeovers – Defence Mechanisms' in M. Olaerts & C.A. Schwarz *Shareholder Democracy: An Analysis of Shareholder Involvement in Corporate Policies'* (2012) 65 at 66-67.
304 Mallin op cit note 296 at 12.
305 King III Report Preface at 10; Code for Responsible Investing in South Africa (2011) can be accessed via http://c.ymcdn.com/sites/www.iodsa.co.za/resource/resmgr/crisa/crisa_19_july_2011.pdf (last accessed 14 September 2013)
306 Schuitema op cit note 271 at 14.
307 Helen Short and Kevin Keasey 'Institutional Shareholders and Corporate Governance in the United Kingdom' in Kevin Keasey, Steve Thompson and Mike Wright *Corporate Governance: Economic, Management and Financial Issues* (1997) 18 at 25.
308 Alan Dignam and Michael Galanis 'Australia Inside-Out: The Corporate Governance System of the Australian Listed Market' (2004) *Melbourne University Law Review* 623 at 632.
309 Stapledon op cit note 290 at 340.

varying approaches to corporate governance issues.[310] Institutional investors diversify their portfolios and as expected do not 'put all their eggs in one basket'.[311] Therefore if their risk is put into context it is understandable that a loss of a small portfolio would hardly impact them.[312]

Institutional shareholders have the necessary resources and information which enable them to be active.[313] In theory, their presence on a board reduces the transaction costs that an individual shareholder may have to bear.[314] However, institutional shareholders are not keen activists and they are more likely to sell their shares during a hostile bid when offered a premium price and instead invest in another company.[315] The individual shareholder on the other hand generally invests for long term benefit and is therefore less likely to sell.[316]

Blockholders

In Australia, so called 'blockholders' are especially common.[317] They are different to institutional shareholders as they are less diversified and thus have more incentive to be active.[318] There are shared and private benefits which arise from being a blockholder.[319] Shared benefits refer to those benefits that can be enjoyed by other types of shareholders.[320] Private benefits refer to those benefits that a blockholder enjoys to the exclusion of other types of shareholders.[321] These private benefits can be to the

310 Ibid.
311 Mallin op cit note 296 at 10.
312 Schuitema op cit note 271 at 14.
313 Dignam and Galanis op cit note 308 at 631-632.
314 Ibid.
315 Armour and Skeel op cit note 142 at at 1748 (Table 2); Short and Keasey op cit note 307 at 25.
316 Robinson op cit note 96 at 295-296.
317 Stapledon op cit note 290 at 334 .
318 Ibid at 333.
319 Ibid at 334.
320 Ibid.
321 Ibid.

detriment of minority shareholders.[322] The downside of the relationship between management and blockholders is that the actions of management are not under close scrutiny.[323] Provided that the interests of blockholders are being taken care of the actions of management will go largely unmonitored.[324] As a result block holders are generally not keen activists.[325]

South Africa

Act provides for Management Powers of the Board

The 2008 Act explicitly provides that the board manages the company unless the Memorandum of Incorporation or the Act provides otherwise.[326] The provision is wider than the standard clause that one would ordinarily have found in a company's constitution.[327] It provides that the director can exercise its powers not only to manage the business of the company, which is standard, but also to manage the affairs of the company.[328] The exact ambit of the ability of the directors to now manage the affairs of the company is unknown.[329] It could be that directors can now decide that a company will apply for liquidation.[330]

Entrenchment of the Board

Even though the board manages the company the 2008 Act 'retains the notion that directors serve at the will of the shareholders'.[331] This is evinced in the legislation which provides that a director can be removed at any time, despite any contrary rule or

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322 Ibid.
323 Dignam and Galanis op cit note 308 at 652.
324 Ibid.
325 Ibid.
326 Section 66(1).
327 Sutherland op cit note 3 at 83.
328 Ibid; s66(1).
329 Sutherland op cit note 3 at 83.
330 Ibid.
331 Ibid at 89.

agreement, by an ordinary resolution, at a shareholders meeting.[332] This in effect prevents directors from entrenching their positions.[333] However, the ability to remove a director is a weapon that shareholders rarely use.[334]

Under the 1973 Act directors could easily entrench their positions.[335] The fact that directors can now easily be removed makes South African companies more vulnerable to takeover bids than companies in the US.[336] This is due to the fact that when a company is taken over in a hostile manner the board is generally replaced, as previously discussed.[337] In the US they have a staggered board arrangement where directors can generally only be removed annually.[338]

Fiduciary Duties of Directors

Fiduciary duties are imposed on directors.[339] Each director stands in a fiduciary relationship to the company.[340] The fundamental fiduciary duty is that of a director to act in the best interests of the company.[341] This essentially dictates that they solely serve the company.[342] The 'company' in this context is widely defined as meaning the shareholders as a collective body.[343] It is uncertain whether this refers to existing and

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332 Section 71(1).
333 Rehana Cassim 'Governance and the Board of Directors' in Farouk HI Cassim, Maleka Femida Cassim, Rehana Cassim et al *Contemporary Company Law* 2ed (2012) 400 at 441.
334 Sutherland op cit note 3 at 89.
335 Companies Act 61 of 1973 s220.
336 Davids, Norwitz and Yuill op cit note 8 at 339-340.
337 Matsaneng op cit note 53 at 145.
338 Davids, Norwitz and Yuill op cit note 8 at 339-340.
339 Sutherland op cit note 3 at 84; Section 76(3)(b).
340 Ibid.
341 Sutherland op cit note 3 at 84.
342 Stein op cit note 20 at 241.
343 Sutherland op cit note 3 at 84; F Cassim op cit note 234 at 20.

future shareholders.[344] Directors can consider other stakeholders provided the shareholders are the ultimate consideration.[345]

King Report

The fiduciary duty of a director is also addressed in the King Report.[346] King I and II both referred to the duty of the directors to consider other stakeholders.[347] This duty manifests itself in the duty to act in good faith and the duty not to exercise powers for collateral purposes.[348] The latter duty encompasses the duty of a director to act within the powers bestowed.[349] A breach of this duty will result in the cancellation of a transaction at the election of the company.[350] If the company suffers a loss as a result of the breach it may claim the extent of the loss from the recalcitrant director.[351]

Business Judgment Rule: South Africa

The fiduciary duty of a director to act in the best interests of the company is subject to the 'business judgment rule'.[352] This rule deems the actions of a director acceptable if the director made the decision based on information that he took reasonable steps to obtain, he did not have a personal interest in the decision that he made and if he did have a personal interest that he declared it and lastly, he had a genuine belief that the decision was in the best interests of the company.[353]

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[344] *Greenhalgh v Arderne* [1951] Ch. 286 CA at 291. See also, *Peter's American Delicacy Co v Heath* (1939) 61 C.L.R. 457; *Provident International Corp v International Leasing Corp* [1969] 1 N.S.W.R. 424; *Ngurli v McCann* (1953) 27 A.L.J. 349.
[345] Sutherland op cit note 3 at 84.
[346] Ibid at 85.
[347] King I Report; King II Report; Sutherland op cit note 3 at 88.
[348] Sutherland op cit note 3 at 84-85.
[349] Stein op cit note 20 at 242.
[350] Ibid.
[351] Ibid.
[352] Section 76(4).
[353] Sutherland op cit note 3 at 89; Saulsbury op cit note 10 at 131. There is a similar test in the UK which focuses on the protection of managerial autonomy.

This essentially protects the director from liability for an action that he took which may have resulted in the company suffering a loss.[354] It includes circumstances where they have made errors in judgment, secondary to corporate management, provided the error is not due to the director failing to act with loyalty and care.[355] This rule has been described as a 'hands-off' or 'laissez-faire' approach as the directors can implement defensive tactics at will and their actions are only scrutinized when someone proceeds with litigation.[356] Some believe that this may reduce the duty of directors and thus undermine the shareholders' rights.[357]

Summary

The two schools provide that either the board or the shareholders can make the decision whether to take frustrating action.[358] The main rationale as to why the shareholders should decide is that the shares are their property and as such they should be able to do with it as they please.[359] The main argument against shareholders deciding is that there is a high turnover of shareholders and that shareholders have varying interests.[360] As discussed, the type of shareholder will determine how active or apathetic the shareholder is.[361]

It was submitted that the board should decide as they manage the company and, as such, they are involved in the company and have all the information that could possibly be relevant to making a decision at their disposal.[362] The main argument against the

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[354] Sutherland op cit note 3 at 89; Saulsbury op cit note 10 at 131.
[355] Karoly Sziklas Gutman 'Tender Offer Defensive Tactics and the Business Judgment Rule' (1983) *New York University Law Review* 621 at 650-651.
[356] Kley op cit note 64 at 40.
[357] Ibid.
[358] Nickig op cit note 5 at 23.
[359] Matsaneng op cit note 205 at 33.
[360] Schuitema op cit note 271 at 14; King II Report Principle 17.3.
[361] This is discussed at 33-35.
[362] *Aronson* supra note 261 at 811; Boardman op cit note 13 at 333; Companies Act 71 of 2008 s66(1).

board deciding is that they may be motivated by self-interest.[363] However, the fiduciary duties of directors can serve as a check and balance.[364] The fundamental fiduciary duty of a director is to act in the best interests of the company.[365] It was submitted that the term 'company' includes shareholders,[366] however, how much weight a director attributes to the interests of shareholders depends on the approach to shareholder primacy.[367]

363 Levitt and Bee op cit note 6 at 41; Cahn and Donald op cit note 76 at 800; Weinberg and Blank op cit note 9 at 18, 576; Sutherland op cit note 3 at 90-91; Phakeng op cit note 255 at 53.
364 This is how it operates in Delaware. The decision of a board of directors to take defensive action is investigated in light of the fiduciary duties of a director and as such performs a checking function. This is fully discussed in Part II of Chapter 5. See, Saulsbury op cit note 10 at 135-136.
365 Sutherland op cit note 3 at 84.
366 F Cassim op cit note 285 at 515.
367 Sutherland op cit note 3 at 88; R Cassim op cit note 234 at 496; F Cassim op cit note 234 at 20; du Plessis, McConvill and Bagaric op cit note 234 at 37.

Chapter 5: International Comparison

In this chapter I will discuss the regimes applied in the UK, the US and Australia. I will focus on how hostile takeovers are regulated and the approach to frustrating action.

I The United Kingdom

Hostile bids first emerged in the US and Britain during the 1950's.[368] It became evident to target boards that they could frustrate a hostile takeover by implementing defensive mechanisms.[369] A sense developed that company law could not sufficiently protect against abuses that may arise when implementing a defensive mechanism therefore the city of London endeavoured to self-regulate.[370] The first attempt came in the form of the 'Notes on Amalgamation of British Businesses of 1959'.[371] The Notes were replaced in the 1960's by the City Code on Takeovers and Mergers, which is still currently in force.[372] It has been used by various jurisdictions as a model.[373] The City Code and the Takeover Panel was introduced as a response to criticism by the press and the UK government of the abusive tactics used by acquirers and targets.[374] The Notes failed to remedy the abuses and it was clear that legislation was necessary.[375]

The Takeover Code was first drafted in 1968.[376] The Panel on Takeovers and Mergers came into operation around the same time in order to administer the Code.[377] It was not legislative therefore compliance was not compulsory.[378] The method of 'cold-

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368 Armour and Skeel op cit note 142 at 1757–1758.
369 Deakin op cit note 69 at 195.
370 Ibid at 195-196.
371 Armour and Skeel op cit note 142 at 1759.
372 Ibid; Saulsbury op cit note 10 at 141-142; Deakin op cit note 69 at 196.
373 Deakin op cit note 69 at 196.
374 Weinberg and Blank op cit note 9 at 210.
375 Ibid.
376 Saulsbury op cit note 10 at 124.
377 Weinberg and Blank op cit note 9 at 209.
378 Saulsbury op cit note 10 at 124.

shouldering'[379] was used, where banks and investors would not do business with companies that violated or that were thought to have violated the Takeover Code.[380] The Panel also used public censures, requested undertakings from the violating company to remedy the breaches and the suspension or withdrawal of a listed company from the Stock Exchange.[381] This method compelled compliance.[382] Defaulters could not secure capital and would not be able to access services provided by investment banks.[383] It was preferred to the force of law for a number of reasons, most notably that it was speedy and flexible in the sense that one would not have to have recourse to the courts as a tool to interpret the Code.[384] This method was used until 2004,[385] when the European Parliament issued a Takeover Directive.[386] The Directive required member states to appoint capable authorities to oversee the bidding process and to charge them 'with all the powers necessary for the purpose of carrying out their duties, including that of ensuring that the parties to a bid comply with the rules made'.[387]

Member States only had to meet the minimum requirements as set out in the Directive.[388] It is a flexible piece of legislation.[389] This is evinced by the fact that Member States can enact additional or stricter standards and provision is made for derogations.[390] The Takeover Directive was initially implemented in the UK by the

[379] Ibid.
[380] Brian E Rosenzweig 'Private Versus Public Regulation: A Comparative Analysis of British and American Takeover Controls' 18 (2007) *Duke Journal of Comparative & International Law* 213 at 218-219 as cited by Saulsbury op cit note 10 at footnote 56.
[381] Kley op cit note 64 at 41; Brian E Rosenzweig 'Private Versus Public Regulation: A Comparative Analysis of British and American Takeover Controls' 18 (2007) *Duke Journal of Comparative & International Law* 213 at 215 as cited by Saulsbury op cit note 10 at footnote 55.
[382] Ibid.
[383] Saulsbury op cit note 10 at 124.
[384] Weinberg and Blank op cit note 9 at 210.
[385] Takeover Directive 2004/25/EC.
[386] Ibid.
[387] Article 4.
[388] Article 3(2)*(a)* and *(b).*
[389] Jan Wouters, Paul van Hooghten and Mattias Bruyneel 'The European Takeover Directive: A Commentary' in Paul Van Hooghten (ed) *The European Takeover Directive and its Implementation* (2009) 3 at 5-6.
[390] Article 3(2)*(a)* and *(b)* read with recital 6 of the preamble.

Takeovers Directive Regulations, which has since been replaced by Part 28 of the UK Companies Act 2006,[391] which came into force on 6 April 2007.[392]

Section 943 of the UK Companies Act provides the Takeover Panel with the necessary authority to implement rules relating to any transaction which may have any effect on the ownership or control of a company and to make rulings.[393] As a result the Code has the force of law.[394] Regulating takeovers in statute allows for legal certainty, in that there is now a means of enforcement.[395] It also ensures transparency, as the public is involved in the process of passing the statute.[396]

Common Law Position in the UK

Defensive mechanisms that would frustrate a takeover bid were strictly prohibited except where the target company could prove that the defence was implemented with the 'proper purpose' of advancing the interests of the company and of the shareholders.[397] This was referred to as the 'proper purpose rule'.[398] It used the general common law duty of a director to exercise his powers for the purpose for which they were granted and applied a fiduciary duty analysis in order to determine whether a defensive action taken was legitimate.[399] It would be legitimate if the dominant purpose of the defensive action was to advance the interests of the shareholders and the company.[400] It would be illegitimate and therefore improper if the dominant purpose was

[391] Godden op cit note 246 at 743.
[392] Ibid at 744.
[393] Companies Act 2006 s943(2)*(a);* s945.
[394] Saulsbury op cit note 10 at 125.
[395] Ibid.
[396] Kley op cit note 64 at 60.
[397] Andrew Johnston 'Takeover Regulation: Historical and Theoretical Perspectives on the City Code' 66 (2007) *Cambridge Law Journal* 422 at 438 as cited by Saulsbury op cit note 10 at footnote 185.
[398] Robinson op cit note 96 at 297. The proper purpose rule became evident in *Hogg* supra note 168.
[399] Johnston op cit note 397 as cited by Saulsbury op cit note 10 at footnote 184.
[400] *Hogg* supra note 168 at 995.

to frustrate the takeover bid.[401] The proper purpose rule is codified in the UK Companies Act.[402]

Statutory Position in the UK

The Takeover Code abrogated the common law position and implemented bright line rules where takeover defences are strictly prohibited.[403] The 'non-frustration rule' is contained in general principle 3 and rule 21 which states that frustrating action is prohibited once an offer has been received or once it becomes imminent, except with shareholder approval.[404] This is also known as the 'passivity rule' as the board is required to remain passive in the face of a hostile takeover bid.[405] It is clear that board neutrality is one of the core principles introduced by the Code.[406]

In this regard general principle 3 provides that there is an obligation on the target board to act in the interests of the company as a whole and that it should not deny the holders of the relevant securities the opportunity to decide an offer on its merits.[407] This is buttressed by rule 21.1 which provides that when an offer has been received or if the target board believes an offer to be imminent, it should not take any action which could result in a *bona fide* offer being frustrated or deny the shareholders an opportunity to decide an offer based on its merits.[408] Rule 21 further lists specific prohibited actions.[409] These actions are simply examples of prohibited actions but do not limit the effect of general principle 3.[410] Rule 21 therefore, like South Africa, has a catch-all phrase and

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[401] Ibid.
[402] Section 17.
[403] Saulsbury op cit note 10 at 141-142.
[404] Takeover Code general principle 3 at B1, rule 21 at I3; Robinson op cit note 96 at 299.
[405] Joshua Berick and Tom Shropshire 'The EU Takeover Directive in Context: A Comparison to the US Takeover Rules' in Paul Van Hooghten (ed) *The European Takeover Directive and its Implementation* (2009) 103 at 104.
[406] Prentice op cit note 303 at 66-67.
[407] General principle 3 at B1.
[408] Rule 21.1(a) at I13.
[409] Rule 21.1(b)*(i)-(v)* at I13.
[410] Weinberg and Blank op cit note 9 at 605.

thereafter lists specific prohibited actions.[411] If there is doubt as to whether a proposed action is in terms of a pre-existing obligation or contract, in other words, whether it arose prior to the offer being received or imminent, the approval of the Panel is necessary.[412]

The effect of the Takeover Code is that it places all the power with the shareholders to analyse the offer and to decide whether or not to vote in favour of it.[413] Therefore if the shareholders approve the defensive measure the directors are released from the prohibition.[414] This reflects that UK company law is shareholder centred.[415]

Scope of the Takeover Code

The provisions of the Code apply to all transactions concerned with takeover bids, regardless of the means in which the takeover is effected.[416] It applies to specific companies, broadly speaking these are:

1. offeree companies over which the UK has jurisdiction in terms of the Directive;[417]
2. public companies that has its registered office in the UK;[418] and
3. private companies that have their registered office in the UK, their central management is located in the UK and a further condition relating.[419]

411 Stein op cit note 20 at 333.
412 Rule 21.1(a) at I13.
413 General principle 3 at B1.
414 Weinberg and Blank op cit note 9 at 605.
415 Prentice op cit note 303 at 68.
416 Godden op cit note 246 at 746.
417 Article 4.
418 Takeover Code para(3)(a).
419 Ibid.

Permissible Defensive Action

It has been argued that despite the passivity rule in the UK there are three defences that can be used.[420] First, directors use competition law as a means to an end but UK legislation has provisions which purpose it is to reduce the possibility of tactical litigation used to frustrate a bid.[421] Second, the advice given by the target board can criticize the offer; this is known as a 'defence document' in the UK.[422] Thirdly, the 'white knight' defence can be implemented, which is where the target company seeks another company or individual to purchase its stock on a friendly basis.[423] The 'white knight' is the 'nice guy'.[424] It could result in the company losing its independence.[425] In this instance the directors would still have to obtain shareholder approval.[426]

Derivative Action

In the UK, as is the case elsewhere, a shareholder can use the derivative action to challenge a decision made by the board of directors.[427] The origin of the derivative action can be found in, *Foss v Harbottle,*[428] where the court held that if a wrong has been committed against the company the proper plaintiff to institute an action to recover damages would be the company itself.[429] However, where the wrong was committed by those in control of the company it is doubtful that they would bring an action against

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[420] Robinson op cit note 96 at 293.
[421] Companies Act 2006 s966(1) and 966(2); *R v Panel on Takeovers and Mergers, Datafin Ltd* [1981] QB815, CA; Christison and Williams op cit note 91 at 794; Prentice and Holland (eds) 'Table of Frequency' (1993) *Contemporary Issues in Corporate Governance* 141 as cited by Robinson op cit note 96 at footnote 197.
[422] Prentice and Holland (eds) 'Table of Frequency' (1993) *Contemporary Issues in Corporate Governance* 141 as cited by Robinson op cit note 96 at footnote 197.
[423] Phakeng op cit note 255 at 54.
[424] Ibid.
[425] Robinson op cit note 96 at 306.
[426] Ibid.
[427] *Aronson* supra note 261.
[428] *Foss v Harbottle* (1843) 2 Hare 461:67 ER 189.
[429] *Foss* supra note 428 at 189; Coetzee op cit note 171 at 291.

themselves.[430] The derivative action is therefore an exception to the proper plaintiff rule.[431]

Summary

The regime in the UK is materially similar to that in South Africa.[432] This is to be expected as the South African takeover regime is based on that of the UK.[433] In both regimes the principle of board neutrality is entrenched in legislation.[434] The most notable difference is that in order to take frustrating action in South Africa the approval of both the TRP and the relevant security holders are required whereas in the UK only shareholder approval is required.[435]

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430 *Foss* supra note 428 at 189; Coetzee op cit note 171 at 290.
431 Coetzee op cit note 171 at 291.
432 Stein op cit note 20 at 333. In the South African Companies Act 71 of 2008 the general rule against frustrating action is contained in s119(1)(c), the catch-all provision is contained in s126(1)(a) and the listed prohibited actions are contained in s126(1)*(b)-(c).* In the UK Takeover Code the general rule is contained in general principle 3 at B1, the catch-all provision is contained in rule 21.1(a) at I13 and the listed prohibited actions are contained in rule 21.1(b) *(i)-(v)* at I13.
433 Wiblin op cit note 105 at 177-178; Boardman op cit note 13 at 332.
434 Berick and Shropshire op cit note 405 at 104; Prentice op cit note 303 at 66-67; Takeover Code rule 21.1 at I13; Davids, Norwitz and Yuill op cit note 8 at 339; Companies Act 71 of 2008 s126(1).
435 Companies Act 71 of 2008 s126(1); Takeover Code rule 21.1 at I13.

II The United States

In the US the target board, when faced with a hostile takeover, will usually first approach the courts with an injunction restraining the acquirer from proceeding with the offer alleging that it is in breach of either securities legislation or anti-trust laws.[436]

Federal Regulation of Tender Offers

On a federal level takeovers are regulated by the Williams Act of 1968.[437] This amended the Securities Exchange Act of 1934 ('the Exchange Act').[438] Amendments were required as there was a gap in the legislature.[439] It is noteworthy to mention that a bidder has a greater chance of acquiring control by making a public offer to buy a specified number of tendered shares during a certain time at a premium in relation to the market price.[440]

The Securities Exchange Commission ('the SEC') is an independent supervisory body.[441] It regulates tender offers in the US but not in the same manner as the Takeover Panel's in the UK and South Africa as it focuses on disclosure and not the duties of directors during a takeover.[442]

The Williams Act applies to offers for securities of 'public corporations whose securities are registered with the Securities Exchange Commission under s12',[443] which is in turn required under s12 and 15 of the Exchange Act.[444] The Exchange Act lays down

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436 Weinberg and Blank op cit note 9 at 617.
437 Palmiter op cit note 60 at 715.
438 Berick and Shropshire op cit note 405 at 104.
439 Palmiter op cit note 60 at 713.
440 Ibid at 715.
441 Kley op cit note 64 at 39.
442 Saulsbury op cit note 10 at 118.
443 Williams Act of 1968 s12.
444 Section13; s14.

minimum substantive procedural requirements.[445] The Act is triggered where any tender offer would result in the bidder holding more than 5 per cent of the target companies equity securities.[446] The term 'tender offer' is not defined in either the Williams Act or the Securities Exchange Rules.[447]

The Exchange Act explicitly provides that the SEC can enforce the Williams Act in a Federal Court[448] but the Act does not make provision for a private cause of action.[449] This raises issues such as who has standing and what remedies are available.[450] The purpose of regulating takeover law is similar to that of the UK, which is to ensure that stock holders are provided with sufficient information and sufficient time in order to make a well-informed decision.[451] The Williams Act has been criticized as being pro-target company.[452] In the years immediately after passing the Williams Act studies reflected that takeover premiums increased substantially and the amount of takeover bids declined.[453] The Act regulates disclosure but not the defensive mechanisms that a target company can take thus resulting in the potential of an uneven playing field.[454]

State Regulation of Tender Offers

US Corporate law is predominantly regulated at state level,[455] as in the law of the state in which the company has been incorporated.[456] It is also regulated by the charter documents of the company.[457] Takeover law in particular is regulated by various

[445] Ibid.
[446] Exchange Act s14(d).
[447] Palmiter op cit note 60 at 718.
[448] Section 21.
[449] Palmiter op cit note 60 at 719.
[450] Ibid at 720.
[451] Ibid at 715.
[452] Ibid at 713.
[453] Ibid at 713-714.
[454] Ibid at 714.
[455] du Plessis, McConvill and Bagaric op cit note 234 at 37.
[456] Berick and Shropshire op cit note 405 at 103.
[457] Ibid.

statues.[458] Naturally, the state laws on tender offers must not conflict with or bring discourse to the objectives of federal laws as this would impact on the ability of Congress to regulate interstate commercial dealings.[459] As a result state laws on tender offers closely resemble the state company law.[460]

Securities legislation was passed in the late 1960's almost simultaneously with the UK City Code.[461] The legislation was not as strict as that of the UK in that defensive mechanisms became commonplace and directors were given carte blanche to implement them as they deemed appropriate.[462] In the 1980's the courts in Delaware endorsed this practice of implementing takeover defences.[463]

Poison Pill

The poison pill was created in the 1980's heyday of hostile takeovers by Martin Lipton.[464] The Delaware Supreme Court has upheld its validity, and over and above this, no state has banned its use.[465] The poison pill is considered a 'show stopper'[466] in the US.[467] It is by far the most widely used defensive mechanism and it is thought to be the most effective in warding off inadequate hostile takeovers.[468] The ultimate purpose of it is to make the shares of the target company less attractive to the acquirer by ensuring

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458 Kley op cit note 64 at 39.
459 *CTS Corp. v Dynamics Corp. of America* 481 US 69 (1987).
460 Cahn and Donald op cit note 76 at 769-770.
461 Deakin op cit note 69 at 197.
462 Berick and Shropshire op cit note 405 at 115.
463 Barry and Hatfield op cit note 69 at footnote 32.
464 Barry and Hatfield op cit note 69 at footnote 32. Martin Lipton is known to be one of the foremost Mergers and Acquisitions lawyer in the US. He is a lawyer at Wachtell, Lipton, Rosen & Katz, a firm he assisted in establishing, as provided by Nickig op cit note 5 at 23; Saulsbury op cit note 10 at 143.
465 *Moran v. Household Int'l, Inc.*, 500 A.2d 1346 (Del. 1985) at 1357.
466 Levitt and Bee op cit note 6 at 43.
467 Ibid.
468 Geoffrey Miller 'Political Structure and Corporate Governance: Some Points of Contrast Between the United States and England' (1998) *Columbia Business Law Review* 51 at 55-56 as cited by Saulsbury op cit note 10 at footnote 151.

that if the acquirer did take over the company, this would actually have an unprofitable result.[469]

Its effect is even more potent when it becomes apparent that it can be adopted by a company at any time by a board resolution.[470] It is generally adopted prior to an actual hostile offer by being drafted into the founding documents of a company and therefore most companies are managed under a 'shadow poison pill'.[471] All defensive mechanisms are subjected to the Unocal test, which is a test that must be satisfied in order to implement a takeover defence; [472] it will be discussed further below.

Broadly speaking the poison pill can take two forms: dilution of rights and the shareholder rights plan.[473] With the former, when any entity owns more than a specified amount of stock, the board purchases additional stock at a discount; this then dilutes the interest of the bidder and makes it necessary for the bidder to acquire more shares to acquire control of the target.[474] There are various features to the shareholders right plan.[475] It is where a shareholder is issued 'one stock purchase right per share of common stock'.[476] Initially the rights are valueless, however once the bidder reaches a certain threshold, usually 15 to 20 per cent of the all the stock of the company, the poison pill is triggered and consequently the shareholders rights are triggered.[477] The

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[469] Barry and Hatfield op cit note 69 at 641; Phakeng op cit note 255 at 54.
[470] Levitt and Bee op cit note 6 at 43.
[471] John C. Coates IV 'Takeover Defenses in the Shadow of the Pill: A Critique of the Scientific Evidence' (2000) 79 *Texas Law Review* 271 at 317 as cited by Jordan M. Barry, John William Hatfield 'Pills and Partisans: Understanding Takeover Defenses' (2012) *University of Pennsylvania Law Review* at footnote 6; *Moran* supra note 465 at 1356; Phakeng op cit note 255 at 54.
[472] *Moran* supra note 465 at 1356.
[473] Matsaneng op cit note 53 at 149.
[474] Ibid.
[475] Ibid.
[476] Ibid at 149-150.
[477] Ibid at 149; Palmiter op cit note 60 at 734-735.

shareholder is then entitled to purchase a certain amount of stock, either in the target or in the acquirer, depending on the type of plan, at a discounted price.[478]

As a result of the above, bidders are cautious not to 'swallow' the poison pill, ie by acquiring sufficient stock to trigger it.[479] It is virtually impossible to takeover a target company whilst a poison pill is in place.[480] The target can 'redeem' a poison pill, ie eliminate it.[481] If an acquirer cannot persuade a target to redeem a poison pill it can attempt to launch a proxy or voting contest to take control of the target board.[482] This is where the bidder appeals to the shareholders of the target company to remove the board of directors so that the shareholders will be able to elect a new board and this board will redeem the poison pill, now making it possible for the acquirer to take control.[483] Proxy contests are however rare as they are costly and difficult to undergo.[484] Most bidders prefer a hostile tender offer over a proxy contest as it provides an element of surprise and thus a better chance of being successful.[485] Also, even if a bidder failed it could still make a profit by selling its 'toehold'[486] position stock in the company.[487]

Defensive Mechanism Debate

The core purpose of defensive tactics is to serve as a deterrent to a potential acquirer. Defensive mechanisms can make the process of acquiring control of the target

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478 Palmiter op cit note 60 at 735.
479 Stephen M. Bainbridge 'Corporation Law and Economics' (2002) at 680-685 as cited by Barry and Hatfield op cit note 69 at footnote 44.
480 Barry and Hatfield op cit note 69 at 643.
481 Ibid.
482 Ibid at 643-644; Palmiter op cit note 60 at 735.
483 Lucian Arye Bebchuk, John C Coates IV and Graham Subramanian 'The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence and Policy' 54 (2002) *Stanford Law Review* 887 at 907-909 as cited by Barry and Hatfield op cit note 69 at footnote 52.
484 Lucian Arye Bebchuk 'The Case for Shareholder Access to the Ballot' in John Armour and Joseph A McCahery *After Enron: Improving Corporate Law and Modernizing Securities Regulation in Europe and the US* (2006) 237 at 239.
485 Palmiter op cit note 60 at 652.
486 Ibid.
487 Ibid.

company a time consuming and expensive one. The more expensive it becomes the riskier it is for the acquirer. This may encourage acquirers to instead seek the cooperation of the board by instead using a friendly approach.[488]

On the other hand it can be argued that it should be allowed as it enables negotiation to take place and during this process a better deal could be negotiated for the shareholders, as previously discussed.[489] Empirical studies have indicated that a board that negotiates usually yields a better deal for shareholders.[490] Also, if it is a bad deal the company should have a means of protecting itself.[491] Defensive mechanisms can be used to deter 'weak or destructive bids'.[492] A hostile takeover could be bad for many reasons, for example, because the price is too low or because there will be issues upon implementation.[493]

Delaware

As previously mentioned, most corporations in the US are incorporated in Delaware for an array of reasons,[494] notably, the fact that companies prefer the flexibility of common law.[495] Companies have different needs at different times therefore it strikes one as appropriate and accords with a sense of justice that the court will take all of the circumstances into account when making a judgment.[496] The nature of the judgments is also such that they can be used as a guide by other companies.[497]

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[488] Kley op cit note 64 at 26-27.
[489] Weinberg and Blank op cit note 9 at 8.
[490] Palmiter op cit note 60 at 728. Bear in mind footnote 69 which cites the inconclusive nature of empirical findings.
[491] Boardman op cit note 13 at 333.
[492] Palmiter op cit note 60 at 728.
[493] Ibid.
[494] Saulsbury op cit note 10 at 118.
[495] Strine op cit note 229.
[496] Ibid.
[497] Saulsbury op cit note 10 at 128-129.

The position in the US is a polar opposite to that of the UK. First, the US allows an array of defensive mechanisms that may be taken by the board of directors without shareholder approval thereby placing the power in the hands of the directors as opposed to the shareholders. Secondly, the US has flexible common law rules that are applied as opposed to the bright line rules used in the UK. Defensive mechanisms are used as negotiating tool in US, and not necessarily to frustrate the bid. Once a target board implements a defensive action they often negotiate with the potential acquirers to obtain a better deal for the shareholders.[498]

There is no Takeover Panel in the US similar to that in the UK and SA.[499] However, it would be inappropriate to establish a similar body with the rules that are presently enforced in the US.[500] The rules would basically empower this body to decide whether it is a good deal or a bad deal based on the effect that it has on the shareholders and the company.[501] One of the general principles of the UK City Code (which has also been implemented in South Africa) is that the Panel is not to make rulings based on financial concerns: that is not its purpose.[502] It should rather focus on equity.[503]

Business Judgment Rule: The US

The business judgment rule is the test used for the duty of care.[504] As discussed, this rule is now used in South Africa.[505] A crucial safety check when the court applies this test is that if there is a reasonable business purpose for the decision of the board, the

[498] Ibid at 115-116.
[499] Ibid at 127.
[500] Ibid at 128.
[501] Ibid.
[502] See generally, Takeover Code general principles at B1. The equivalent can be found in s119(1) of the Companies Act 71 of 2008.
[503] Takeover Code general principle 1 at B1.
[504] Saulsbury op cit note 10 at 131. There is a similar test in the UK which focuses on the protection of managerial autonomy.
[505] This is discussed at 38.

court may not substitute its own judgment for that of the boards.[506] There is an 'entire fairness' test applied where there is a conflict of interest or other circumstances indicative of bad faith.[507]

Pre-Unocal: 'Dominant- Motive' Review

To determine whether directors were taking defensive action in order to entrench their positions, the initial test used by the court was to ascertain whether the board could demonstrate a reasonable investigation into a business purpose for the defensive mechanism.[508] Once the board discharged this burden it fell to the challenger to prove that the dominant motive of the boards' defensive action was entrenchment of their position.[509]

This test was heavily criticized by academics as being laborious and failing to take account of the structure of the board which favoured entrenchment.[510] The courts abundantly accepted virtually any business purpose used as a defensive mechanism.[511] It basically gave directors free reign to implement defences without the required checks and balances.[512]

Unocal Test

The Delaware Supreme Court in 1985 in the landmark case of *Unocal Corp. V Mesa Petroleum Co*[513] established an 'enhanced duty business judgment rule' in circumstances where the board has decided to implement a defensive measure to

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506 *Unocal Corp. v. Mesa Petrol. Co*., 493 A.2d 946 (Del. 1985) at 954.
507 Davids, Norwitz and Yuill op cit note 8 at 359.
508 *Cheff v. Mathes*, 199 A.2d 548 (Del.1964) as cited by Palmiter op cit note 60 at 730.
509 Palmiter op cit note 60 at 730.
510 Ibid.
511 Ibid.
512 Ibid at 731.
513 *Unocal* supra note 506.

frustrate a hostile takeover.[514] It is also known as the Unocal test, proportionality test or enhanced judicial scrutiny test.[515] It reversed the onus of proof to the director (which is thought to be a step in the right direction).[516] The court pronounced that the rationale for an enhanced test was due to the fact that there was a possibility that the board may be implementing a defensive mechanism for their own interests in order to entrench themselves[517] rather than that the defensive mechanism was in the best interests of the company.[518]

To satisfy the test there is a two prong enquiry.[519] As a preliminary issue the target board is obligated to determine if the offer is in the best interests of the company and its shareholders.[520] In order to satisfy the test the board must fulfil both legs of the test[521] and must show that reasonable grounds existed for the belief that the corporate policy and effectiveness was being threatened and that its response to the threat was reasonable.[522]

Leg one of the test is satisfied by showing due investigation on the part of the board.[523] Here, it must be borne in mind that, there does not have to be an actual threat to corporate policy but rather a perceived threat which warrants implementation of a defensive measure.[524] The board should also show that the price tendered for the

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514 Palmiter op cit note 60 at 731; *Unocal* supra note 506.
515 Ibid*;* Matsaneng op cit note 53 at 155.
516 Kley op cit note 64 at 39-40.
517 John F Olson 'South Africa Moves to a Global Model of Corporate Governance but with Important National Variations' (2010) *Acta Juridica: Modern Company Law for a Competitive South African Economy* 219 at 238.
518 Palmiter op cit note 60 at 731; *Unocal* supra note 506 at 954.
519 Palmiter op cit note 60 at 732.
520 Ibid at 731; *Unocal* supra note 506 at 954.
521 Palmiter op cit note 60 at 732.
522 Ibid at 731; *Unocal* supra note 506 at 955.
523 Ibid.
524 *Moran* supra note 465 at 1356.

shares was inadequate and that there was a strong likelihood that the majority of the shareholders would have tendered into the inadequate offer.[525]

Leg two of the test is satisfied if the board can show that the defensive mechanism implemented was reasonable or proportionate to the threat.[526] Crucial in this regard, is that the board cannot implement a defensive mechanism as a blanket rejection to all offers.[527] The second leg ties in quite closely with the issue of how long a board can use a poison pill to ward off a hostile takeover.[528] Other general considerations are the timing and nature of the particular offer, the effect on all stakeholders (in particular the shareholders) and the risk that the takeover will not materialize as implementation is not possible.[529] The court will uphold the defensive mechanism as due fulfilment of the business judgment rule if it is found to be lawful and reasonable, and that the board exercised its discretion *bona fide* and with care.[530]

The *Unocal* case left questions unanswered. When could a threat be said to be cognizable? When is an action taken by the board defensive and when is it plainly preventing an acquirer from making a bid? Lastly, how is it determined what a proportionate and reasonable action is in response to a definite threat?[531]

The Delaware courts have applied the Unocal test inconsistently.[532] In one case it relaxed the two prong test,[533] in another it rejected the first leg of the test stating that the

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[525] *Air Products & Chemicals, Inc. v. Airgas Inc*. 16A.3d 48 (Del. Ch. 2011) at 55.
[526] Palmiter op cit note 60 at 731; *Unocal* supra note 506 at 955.
[527] Ibid.
[528] *Moran* supra note 465 at 1354; *Unocal* supra note 506 at 954-55, 958; Martin Lipton 'Pills, Polls, and Professors Redux' 69 (2002) *University of Chicago Law Review* 1037 at 1054 as cited by Saulsbury op cit note 10 at footnote 162.
[529] Palmiter op cit note 60 at 728.
[530] *Unocal* supra note 506 at 957.
[531] Nickig op cit note 5 at 24.
[532] Matsaneng op cit note 53 at 156-157.
[533] Ibid.

test was not necessary.[534] Finally, it was held that when applying the test the court should determine whether the decision of the board was reasonable, not whether it was perfect.[535]

Notably, the jurisprudence changed with the times. During the 1980's, the court exercised great caution and permitted board activism only where there were convincing justifications in addition to maximizing shareholder wealth. During the 90's, the courts became more lenient and permitted defensive tactics more liberally. In the 2000's, the court has more readily imposed fiduciary duties on the directors of the target board. [536]

The line of case law demonstrates that the application of the test is not clear cut but rather a complex affair.[537] Critics have opined that the Delaware courts are too deferential to the management of a target company whereas others have praised it as providing directors with sufficient latitude to meaningfully react to bids on behalf of its stakeholders.[538]

The Revlon Duty

Soon after *Unocal*, in the case of *Revlon, Inc. V MacAndrews & Forbes Holdings, Inc*.[539] the Delaware Supreme Court elaborated on circumstances in which the duty of the board changes from preservation of the target company to maximization of the value of the target company where the goal is to get the best price for the shareholders.[540] It has come to be known as 'the Revlon duty'.[541] When this duty exists the board may not

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[534] *Paramount Communications Inc v Time Inc* 571 A.2d 1140 (Del Supr 1989) at 1153.
[535] *Unitrin Inc v American General Corp* 651 A.2d 1361 (Del Supr 1995) at 1385.
[536] Palmiter op cit note 60 at 732.
[537] Matsaneng op cit note 53 at 156-157.
[538] Palmiter op cit note 60 at 733.
[539] *Revlon, Inc. v MacAndrews & Forbes Holdings, Inc* 506 A.2d 173 (Del. 1986).
[540] Ibid at 182.
[541] Saulsbury op cit note 10 at 139.

implement defensive mechanisms to frustrate a bid.[542] This duty arises when the board is offered various adequate bids.[543] Since the bids are adequate the first leg of the Unocal test will not be satisfied as the bids would not be a threat to the 'corporate policy and effectiveness' of the target company.[544] Therefore if the board is faced with only one offer, the defensive mechanism will be analyzed under the Unocal test.[545] If it becomes clear that the dissolution, break up or sale of the company is inevitable then obtaining the highest price for the shareholders should be the driving force behind the decisions of the board.[546]

Summary

The takeover regime in the US is the opposite of that in South Africa and the UK.[547] Defensive mechanisms are widely employed, the board makes the decision and frustrating action is entrenched in the common law.[548] The drawbacks are that the US does not have a Takeover Panel that serves a similar function to that of South Africa and the UK.[549] The SEC in the US regulates issues of disclosure and does not focus on defensive mechanisms.[550] It is submitted that the common law system, although providing flexibility and current decisions, breeds legal uncertainty, as a result of the inconsistency with which the Delaware Supreme Court applies the Unocal test.[551]

542 *Revlon* supra note 539 at 185.
543 Ibid.
544 Ibid at 182.
545 Saulsbury op cit note 10 at 139.
546 *Paramount Communications* supra note 534 at 1150; *Revlon* supra note 539 at 173, 182.
547 Saulsbury op cit note 10 at 115-116; Boardman op cit note 13 at 332.
548 Berick and Shropshire op cit note 405 at 115; Barry and Hatfield op cit note 69 at footnote 32.
549 Saulsbury op cit note 10 at 118.
550 Ibid.
551 Ibid at 115-116; Matsaneng op cit note 53 at 156-157; *Paramount Communications* supra note 534 at 1153; *Unitrin* op cit note 535 at 1385; Palmiter op cit note 60 at 732.

The directors are given wide powers to implement defensive mechanisms.[552] This power is balanced by the fiduciary duty imposed on directors which finds expression in the Unocal test.[553]

[552] Berick and Shropshire op cit note 405 at 115.
[553] Saulsbury op cit note 10 at 135-136.

III Australia

The takeover laws in Australia have been noted to be the most limiting of all capitalist nations.[554] It is based on the Eggleston Principles which have embedded in them notions of equal opportunity and the protection of minority shareholders.[555] The principles are codified in the Corporations Act ('the Act').[556] Legislation regulating takeovers came into play in Australia in the early 1960's.[557] This is around the same time as the US and the UK.[558]

Traditionally, Australia adopted a fiduciary duty analysis but the Takeover Panel now uses a Guidance Note on Frustrating Action.[559] The Corporate Law Economic Reform Program provided that one of the main aims was to ensure that the shareholders of the target company made the decision as to whether to accept or reject the bid.[560] Australia is therefore shareholder centric like the UK and South Africa.[561]

Market for Corporate Control

Of the completed mergers and acquisitions transactions, involving companies listed on the Australian Stock Exchange ('the ASX') as target companies, 18.7 per cent were hostile takeovers.[562] Whether the presence of blockholders in Australia will influence the frequency of hostile takeovers depends on whether a blockholder has a good relationship with management, if so, there is a slim likelihood of a hostile takeover

[554] Justin Mannolini 'Convergence or Divergence: Is There a Role for the Eggleston Principles in a Global M&A Environment?' (2002) 24 *Sydney Law Review* 336 at 336 as cited by Jennifer G. Hill in 'Subverting Shareholder Rights: Lessons from News Corp's Migration to Delaware' (2010) *Vanderbilt Law Review* at footnote 136.
[555] Hill op cit note 554 at 24.
[556] Corporations Act 2011 (Cth); Hill op cit note 554 at 24.
[557] Austin and Ramsay op cit note 36 at 1354.
[558] Armour and Skeel op cit note 142 at 1757-1757.
[559] Guidance Note 12 ('GN12').
[560] Explanatory Memorandum, Corporate Law Economic Reform Program Bill 1998 (Cth) 38; 'Corporate Law Economic Reform Program, Takeovers- Corporate Control: A Better Environment for Productive Investment' Paper No 4 (1997) 32 at 37.
[561] GN12 Note3; Davids, Norwitz and Yuill op cit note 8 at 339.
[562] Stapledon op cit note 290 at 331.

occurring as the blockholder will not vote in favour of it.[563] Of the 18.7 per cent only 7.2 per cent were successful.[564] This is considerably lower than the statistics in the US and the UK.[565] Studies reveal that the majority of Australian companies defeat hostile takeovers.[566] It is thought that this can attributed to the close relationship between blockholders and management.[567] This is very different to the US, where, despite the fact that defensive measures are more readily implemented, it generally results in a better negotiated deal for shareholders and not in the defeat of a hostile takeover.[568]

Regulatory Framework

The takeover provisions are contained in Chapter 6 of the Act.[569] The relevant sections will apply to listed entities, listed managed investment schemes and to unlisted companies provided they have more than fifty members.[570] When Australian takeover law was reviewed the Eggleston Committee provided that when a bidder makes an offer that can result in him acquiring a substantial interest in a company, it was vital to ensure that certain requirements are met, these requirements came to be known as the Eggleston Principles.[571] These principles underlie takeover law and are codified in s602 of the Act which sets out the purposes of the takeover provisions.[572] It provides that in a takeover it is essential to ensure that the shareholders and directors are provided with all the relevant information.[573] In particular, that they are aware of the bidders identity.[574]

[563] Anil Shivdasani, 'Board Composition, Ownership Structure and Hostile Takeovers' (1993) 16 *Journal of Accounting and Economics* 167 as cited by Dignam and Galanis op cit note 308 at 640, footnote 100.
[564] Stapledon op cit note 290 at 331.
[565] Ibid at 331.
[566] Dignam and Galanis op cit note 308 at 641.
[567] Ibid.
[568] G William Schwert 'Hostility in Takeovers: In the Eyes of the Beholder?' (2000) 55 *Journal of Finance* 2599 at 2609, 2624-2632, and 2638-2639 as cited by Dignam and Galanis op cit note 308 at footnote 98, 100 and 100, respectively.
[569] Austin and Ramsay op cit note 36 at 1349.
[570] Section 602(a)*(i)-(iii)*.
[571] Second Interim Report to the Standing Committee of Attorneys-General on 'Disclosure of Substantial Shareholdings and Takeovers' (Feb 1969) paper no 43 Company Law Advisory Committee at 6.
[572] Austin and Ramsay op cit note 36 at 1357-1358.
[573] Section 602(b)*(iii)*.
[574] Section 602(b)*(i)*.

Second, that sufficient time is provided to assess the merits of the offer.[575] And lastly, that all shareholders have an equal opportunity to participate in any benefit which arises as a result of the offer.[576] The purposes are so that well informed decisions are made based on the merits of the offer.[577] It is also to ensure an efficient and competitive market.[578]

The takeover provisions contain a general prohibition against a person or persons entering into a transaction which results in that person or persons acquiring voting power in excess of the threshold 20 per cent of the shares or an increase of their voting power where that person already has above 20 per cent and they acquire shares that result in them holding between 20 per cent and 90 per cent.[579] The most important exception is where the acquisition is as a result of the acceptance of a takeover bid.[580] The Act recognises two types of takeover bids: market and off-market bids.[581] There are various differences between the two.[582]

The Australian Securities and Investments Commission ('the ASIC') is the national securities regulator.[583] It has the power to grant an exemption from compliance with the takeover provisions.[584] This is important in the context of Australia which was criticised for its so-called 'black-letter' takeover law.[585] The Takeover Panel is established in terms of the ASIC Act.[586] It can review decisions of the ASIC[587] and in turn the decisions

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[575] Section 602(b)*(ii)*.
[576] Section 602(c).
[577] See, footnote 571.
[578] Ibid.
[579] Section 606(1); Tony Ciro and Christopher Symes *Corporations Law in Principle, 8th Edition* 8 ed (2009) 501-505.
[580] Section 611, item 1.
[581] Ciro and Symes op cit note 579 at 506.
[582] Ibid.
[583] Austin and Ramsay op cit note 36 at 1440-1442; Australian Securities and Investments Commission Act 2001 (Cth) ('ASIC').
[584] Section 655(a).
[585] Austin and Ramsay op cit note 36 at 1441.
[586] Section 171.

of the Panel are subject to judicial review.[588] The Takeover Panel replaced the Corporations and Securities Panel, which was established to resolve disputes arising from takeovers[589] primarily to prevent parties from resorting to litigation as a tactic to frustrate a hostile takeover.[590]

Frustrating Action

The Panel publishes what is called Guidance Notes.[591] These notes provide how it intends to exercise its powers under the Act.[592] Guidance Note 12 deals with frustrating action and defines it as an action by a target company which frustrates a takeover bid and due to this action a bid lapses or is withdrawn or a potential bid, which is a bid that the offeror has informed the target company of, fails.[593] In a landmark case of *Re Pinnacle VRB Ltd*[594] the Pinnacle (No 8) principle was developed.[595] This principle placed the emphasis of the frustrating action on the effect of the decision made by the directors instead of the purpose for which they made their decision.[596]

Interestingly, a distinction is often drawn between defence 'strategies' and defence 'tactics'.[597] A tactic is in response to an impending bid whereas a strategy is something that was planned and already in place for the purpose of defending against a bid.[598] All actions of directors are subject to their general duty to act in the best interests of the

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[587] Section 656(a).
[588] Commonwealth Constitution and the Administrative Decisions (Judicial Review) Act 1977 (Cth).
[589] Section 659AA.
[590] Ciro and Symes op cit note 579 at 520.
[591] Austin and Ramsay op cit note 36 at 1475.
[592] James McConvill 'Getting a Good Buy with a little Help from a Friend: Turning to the United States to go Forward with Australian Takeovers Regulations' (2006) *Syracuse Journal of International Law and Commerce* 153 at 189.
[593] GN12 Note5.
[594] *Re Pinnacle VRB Ltd* No 5 2001 39 ACSR 43.
[595] Austin and Ramsay op cit note 36 at 1474.
[596] Ibid; Jennifer G. Hill 'Back to the Future? Bigshop 2 and Defensive Tactics in Takeovers' (2002) 20 *Companies & Securities Law Journaul* 126 at 129-30 as cited by Hill op cit note 554 at footnote 144.
[597] Ciro and Symes op cit note 579 at 518.
[598] Ibid.

company and to use their powers for a proper purpose.[599] Guidance Note 12 provides that its general policy is that shareholders, rather than directors, should make decisions which may have an impact on the ability of shareholders to participate equally in an offer or incident which have an effect on their control and ownership.[600] For these policy reasons there are limits to the defensive actions that directors may take to defend against a hostile takeover.[601] An example of this is that the board of a target company, may not, without the prior approval of the shareholders, issue shares for three months from the date that the target company is informed in writing, that another person or entity is making or has proposed a takeover.[602] This becomes relevant when target boards want to implement the 'white knight' defence.[603]

The action of a target board may warrant a declaration of unacceptable circumstances by the Panel, in other words, not every action which has the effect of frustrating a bid will give rise to a declaration of unacceptable circumstances.[604] The Panel has extensive authority to make orders including preventing or unwinding a transaction or action and requiring shareholder approval.[605] It can also override directors' decisions.[606] If a possibility exists that the action by directors could frustrate a bid, the Panel will generally require that the shareholders at the very least have an opportunity to consider the merits.[607]

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[599] Ibid.
[600] GN12 Note3.
[601] Helen Anderson, Michelle Welsh, Ian Ramsay *et al* 'The Evolution of a Shareholder and Creditor Protection in Australia: An International Comparison' (2012) *International and Comparative Law Quarterly* 171 at 190.
[602] Australian Securities Exchange Listing Rule 7.9.
[603] Phakeng op cit note 255 at 54; Anderson, Welsh, Ramsay et al op cit note 601 at 190.
[604] Ciro and Symes op cit note 579 at 517; Austin and Ramsay op cit note 36 at 1475.
[605] GN12 Note18.
[606] GN12 Note19.
[607] Austin and Ramsay op cit note 36 at 1475.

Unacceptable Circumstances

Initially, the Act contained a definition of 'unacceptable circumstances' and it would only make a declaratory order if one of the conditions, based on the Eggleston Principles, were met.[608] The Panel opined that the 'black-letter' law of the takeover provisions would not be sufficient to deal with all the circumstances that may arise.[609]

A declaration of unacceptable circumstances is now governed by s657A(2) of the Act.[610] An application can be made by any person whose interests have been affected such as the target, the bidder or the ASIC.[611] The Panel cannot act on its own motion.[612] The term 'unacceptable circumstances' is not defined in the Act; however, the word 'unacceptable' implies that the circumstances cannot continue as is and that they necessitate consideration.[613]

When making a decision regarding a declaration the Panel must have regard to the conditions set out in the subsection, the purposes of the takeover provisions as provided in s602 and any other relevant matter.[614] The Panel must also take into consideration whether the declaration will be against public interest.[615]

Guidance Note 12

The Note provides examples as to what the Panel may view as frustrating action, but they are just that, examples.[616] It does not mean that if one of the examples provided

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608 Ibid.
609 Guidance Note 1 ('GN1').
610 Section 657A(2).
611 Section 657(c).
612 Austin and Ramsay op cit note 36 at 1462.
613 *Attorney- General (Cth) v Alinta Ltd* (2008) 233 CLR 542; [2008] HCA 2 at 169.
614 Ciro and Symes op cit note 579 at 522; s657A(3)(a) and (b).
615 Section 657A(2).
616 GN12 Note2.

appear before the Panel that it will on that basis conclude that it is a frustrating action.[617] Examples of frustrating action include a substantial issue or repurchase of shares; the acquisition or disposal of an important asset; substantial change to the terms of a liability or share plans of the company; and the declaration of an extraordinary dividend.[618]

An offeror can make its offer subject to conditions, once an action triggers a condition it amounts to a frustrating action.[619] Whether the frustrating action gives rise to unacceptable circumstances depends on the effect that it has on shareholders and the market.[620] The Panel has regard to an array of circumstances surrounding the bid and the frustrating action.[621] It is interesting to note what is considered.

With regard to considerations surrounding the bid the Panel will evaluate the period for which the offer has been open,[622] the prospects of the transaction being implemented[623] and whether there are any commercially significant conditions attached to the bid.[624] The type of conditions that the Guidance Note lists are those that may be too restrictive,[625] or conditions that require the cooperation of the target board,[626] or conditions that prevent the target board from seeking alternative offers[627] or a condition that the target company enter into a major transaction that it did not envisage.[628]

[617] GN12 Note2.
[618] GN12 Note1.
[619] GN12 Note7.
[620] GN12 Note7.
[621] See generally, GN12.
[622] GN12 Note11(a).
[623] GN12 Note11(a).
[624] GN12 Note11(b).
[625] GN12 Note11(c)*(1)*.
[626] GN12 Note11(c)*(2)*.
[627] GN12 Note11(c)*(3)*.
[628] GN12 Note11(c)*(4)*.

With regard to consideration surrounding the frustrating action the Panel will have regard to whether there are alternative offers, whether there is a business rationale behind the frustrating action or whether it was taken in the ordinary course of the targets business.[629]

Examples are provided of action that may give rise to unacceptable circumstances[630] and those that will not.[631]

> The following are some examples of actions that may give rise to unacceptable circumstances:
> (a) issuing new shares (or convertible securities), or repurchasing shares, if significant in the context of the target's issued capital or the bid
> (b) acquiring a major asset, including by making a takeover bid, or disposing of one
> (c) undertaking significant liabilities or materially changing the terms of its debt (where the takeover would not have given rise to these changes)
> (d) declaring a special or abnormally large dividend
> (e) significantly changing company share plans or
> (f) entering into joint ventures.[632]

Interestingly it will generally not give rise to unacceptable circumstances if the frustrating action leads to the target company choosing between two offers[633] or requiring shareholder approval or making a decision conditional upon shareholder approval.[634] If shareholder approval is required the Panel will consider a number of listed things.[635] Also, if the target company does not cooperate, 'seeks alternatives' or

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[629] GN12 Note11(f)-*(h)*.
[630] GN12 Note12.
[631] GN12 at 5.
[632] GN12 Note12(a)-*(f)*.
[633] GN12 Note13.
[634] GN12 Note14.2.
[635] GN12 Note15.

rejects the bid it generally will not result in a declaration of unacceptable circumstances.[636]

The Panel provides explicitly that it does not apply director's duties but instead creates its own duties and obligations.[637] Therefore, regardless of directors' duties a frustrating action can give rise to unacceptable circumstances.[638]

Summary

Australia has been referred to as the middle ground between the UK and the US.[639] This is due to the fact that the restrictions on frustrating action are not quite as strict as the UK however frustrating action is strongly discouraged; therefore it is not as liberally used as in the US.[640] The ability of directors to implement defensive mechanisms is limited, especially with regard to listed companies.[641]

Australia has a blended regulatory regime.[642] The Guidance Note on frustrating action is a guideline but the declaration of an unacceptable circumstance connected to the frustrating action is legislative.[643] This provides a certain degree of flexibility but also with the assurance and support of the legislature.[644]

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[636] GN12 Note16.
[637] GN12 Note9.
[638] GN12 Note10.
[639] Boardman op cit note 13 at 324.
[640] Ibid at 332.
[641] See generally, GN12.
[642] Boardman op cit note 13 at 324. The system in Australia is regulated by GN12 and Corporations Act 2001 (Cth) s657A(2).
[643] Guidance Note 12; Corporations Act 2001 (Cth) S657A(2).
[644] Saulsbury op cit note 10 at 125. The legislature provides consequences for non-compliance, which, as previously discussed was an issue in the UK when the Takeover was first drafted as it was not legally enforceable. This was discussed in Part I of Chapter 5.

Chapter 6: Conclusion- Preferred Approach

Economic Climate in SA

Empirical studies in the UK have shown that the prohibition of hostile takeovers increased the amount of successful hostile takeovers.[645] The economic climate in South Africa is unique as a result of the political system of apartheid that was in force.[646] This system enforced racial segregation and the aftermath still reflects in the demographics of shareholders.[647] There are policies in place to address this and it is aimed at shareholder democracy.[648] The term 'shareholder democracy' encapsulates the influence that shareholders have on the direction of a company and in promoting their own interests within that structure.[649] Many corporate governance principles developed in the King Report are now reflected in company legislation.[650] The King Reports have an undertone of political and social transformation and therefore differ from equivalent international documents.[651]

South Africa now has a democratic system and has an obligation not only as the leading economy in Africa, but, also, as a hub of natural resources, to advance the economy.[652] Black entrepreneurs struggle to break into the shareholder market for a number of reasons.[653] One is the struggle to secure funds.[654] Another is the fact that the mindset of other key game players have not shifted and as result they do not appreciate the

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645 Armour and Skeel op cit note 142 at 1738 (Table 1).
646 Matsaneng op cit note 14 at 29.
647 Ibid.
648 Ibid; Sutherland op cit note 3 at 79.
649 Sutherland op cit note 3 at 79.
650 Ibid.
651 Ibid at 81.
652 Olson op cit note 517 at 247.
653 Peter Nkaiseng 'Implementing BEE: Radical Change in Direction Required' (2006) *Management Today* 47 at 47.
654 Ibid.

significance of BBBEE transactions for the sustainable growth of the economy and to create ownership that reflects the demographics.[655]

The primary objective of takeover law in South Africa is to protect stakeholder interests, the secondary interest is to develop investment.[656] However, there must be a balance between the protection of stakeholders, particularly the minority shareholders, and the encouragement of economic activity.[657] If the legislation places too much emphasis on the protection of shareholders of target companies it could make takeovers expensive and disproportionately burdensome, thereby discouraging possible bidders and investors.[658] Of particular significance in South Africa is the safeguarding of the disenfranchised and minorities.[659]

There are hardly any hostile takeovers in South Africa and regulators do not seem to have the ability to deal with it constructively when it arises.[660] The most well-known attempts at a hostile takeover that have occurred recently were both defeated.[661] These are that of Standard Bank by Nedbank and that of Goldfields by Harmony Gold.[662]

Why Shareholders Should not Decide

It is argued that the drawbacks of defending against a hostile takeover do not sufficiently outweigh the benefits and as a result the board should be able to defend against these types of takeovers.[663] The aggressive US approach where directors have

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655 Ibid.
656 Boardman op cit note 13 at 311.
657 Davids, Norwitz and Yuill op cit note 8 at 338.
658 Boardman op cit note 13 at 312.
659 Ibid at 312, 333.
660 In *Goldfields Ltd v Connellan* [2005] 3 All SA 142 (W) it was stated that merely 11 hostile takeovers had been evaluated by regulators under the regime set up in the 1900's.
661 Davids, Norwitz and Yuill op cit note 8 at 370.
662 Ibid.
663 Kley op cit note 64 at 2.

wide discretion to implement defensive action would not be appropriate in the context of South Africa's history of disenfranchisement.[664]

In South Africa the general rule is that frustrating action is prohibited when an offer has been received or when it is imminent.[665] The exception to this general rule is when the specific frustrating action is approved by the TRP and the shareholders or if it is in terms of a pre-existing agreement or obligation entered into before an offer was received or was imminent.[666]

Earlier it was discussed that there are two schools of thought with regard to whether a shareholder or the board of directors should approve frustrating action.[667] I submit that the ultimate decision should not lie with the shareholders.[668] Despite being the owners of the company there are too many indicators that if the ultimate decision laid with the shareholders that their decision may actually be to their detriment.[669] It is idealistic that primarily based on this notion of ownership that shareholders should decide.[670]

Generally, in modern corporate law there is a high shareholder turnover, coupled with the fact that their interests and incentives differ vastly depending on what type of shareholders they are.[671] This in turn as evinced affects whether they are long term or short term shareholders and whether they are keen activists.[672] Interestingly, a case in

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[664] Boardman op cit note 13 at 333.
[665] Section 126(1) and (2).
[666] Ibid.
[667] Nickig op cit note 5 at 23.
[668] Companies Act 71 of 2008 s126; Takeover Code Rule 21.1.
[669] Godden op cit note 246 at 744; Matsaneng op cit note 205 at 33; Sutherland op cit note 3 at 91.
[670] Ibid.
[671] Schuitema op cit note 271 at 14; King II Report on Corporate Governance (2002) Principle 17.3; Holber op cit note 274 at 125. Discussed in Chapter 4.
[672] Robinson op cit note 96 at 295-296; Armour and Skeel op cit note 142 at 1748 (Table 2); Dignam and Galanis op cit note 308 at 631-632, 652; Schuitema op cit note 271 at 14; Weinberg and Blank op cit note 9 at 16.

the US was decided based on the differing interests of shareholders.[673] The case concerned the maintenance of a poison pill during a hostile takeover.[674] The court noted that the economic incentives and preferences were sufficiently different to warrant individual treatment.[675]

In Chapter 4 the importance of shareholder activism was discussed. This concept encompasses the involvement of a shareholder in a company.[676] It is presumed that if the shareholder is involved in the company that he or she will be knowledgeable as to the operations and performance of the company thus being able to participate valuably in decisions made as decisions will be made on an informed basis.[677] The main shareholders in South Africa are institutional shareholders.[678] Logically, as discussed, it is thought that they would be keen activists as they have the resources at their disposal; however, studies have shown that they are in fact apathetic in this regard.[679] One argument as to why shareholders should decide is that shareholders take all the risks, however, the risk of institutional shareholders put into context is not that big of a risk, as compared to the type of risk it would be for an individual shareholder.[680] Individual shareholders are the minority shareholders in South Africa and they do not have the resources to be active shareholders, over and above this, they lack the incentive to be active because they cannot justify expending time and money when it is thought that their decisions will not have a large impact as they are bound by the majority rule.[681]

If one assesses that the two major groups of shareholders in South Africa are not keen activists it becomes difficult to justify why the decision to take frustrating action should

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[673] *Air Products* supra note 525.
[674] Holber op cit note 274 at 125.
[675] Ibid.
[676] Sutherland op cit note 3 at 79.
[677] *Aronson* supra note 261 at 811; Boardman op cit note 13 at 333.
[678] Matsaneng op cit note 205 at 31.
[679] Armour and Skeel op cit note 142 at 1748 (Table 2); Short and Keasey op cit note 307 at 25.
[680] Schuitema op cit note 271 at 14.
[681] Cahn and Donald op cit note 76 at 798; Christison and Williams op cit note 91 at 792.

lay with them as they do not know the position of the company and therefore whether the frustrating action will be the best decision or not.[682] Also, shareholders may not be sufficiently competent to make an informed decision.[683]

Due to the concern for the minority shareholders in South Africa, it is understandable that the legislature may be reluctant to disenfranchise them in this manner, however, considering that it could ultimately benefit them, the end may justify the means.[684] Also, it was discussed that shareholders hardly make use of their power to remove directors; it begs the question whether they would participate and use their power to make a decision regarding frustrating action.[685]

Guidelines of the TRP

When the TRP makes a decision whether to approve frustrating action the natural inquiry that follows is the basis on which this decision is made. It is astonishing that this power was given to the TRP yet there is no guideline as to how to use it. This means that the TRP will have wide powers when making a decision as to whether to allow frustrating action. One can assume that they will be guided by the objects of the TRP.[686]

As discussed, Australia has a blended system as it uses hard and fast rules as found in their Corporations Act and they also use the Guidance Note which is a guideline used by the Takeover Panel.[687] It is submitted that the Guidance Note plays an invaluable role in bringing practical considerations to the forefront and not merely seeing the law as

[682] Ibid; Armour and Skeel op cit note 142 at 1748 (Table 2); *Aronson* supra note 261 at 811; Boardman op cit note 13 at 333.
[683] Gerard Hertig and Joseph A McCahery 'Company and Takeover Law Reforms in Europe' in John Armour and Joseph A McCahery *After Enron: Improving Corporate Law and Modernising Securities Regulation in Europe and the US* (2006) 545 at 562.
[684] Boardman op cit note 13 at 312.
[685] Robinson op cit note 96 at 306.
[686] Companies Act 71 of 2008 s119(1); Guidance Note 12.
[687] Guidance Note 12; ASIC Act 2001 (Cth) s17; Corporations Act 2001 (Cth) s657A(2).

black-and-white.[688] The importance of flexibility in the area of takeover law was raised.[689] This area of law is time sensitive, ever changing and complex.[690] Australia has the benefit of the enforcement of the legislature[691] (which, as discussed, is what the previous UK and South African system was lacking) and the luxury of the capability of taking cognisance of realistic circumstances.[692] It is submitted that South Africa would benefit greatly from this type of flexibility.

Should the Board Decide Then?

I argued above that the ultimate decision should not lie with the shareholders of the company. In the same vein I do not believe that it is wise for the directors to have exclusive power either. I do however believe that it is preferable to let the decision lay with the board. I will therefore proceed to consider the main reasons against the board deciding and discuss the check and balance that is found in the fiduciary duties of directors.[693]

The main argument as to why directors should not decide is that they are motivated by self-interest.[694] As discussed, this finds reflection in two ways: they look to entrench their positions in the company after new management has taken over or if they cannot remain in the company post hostile takeover, they will seek to secure a form of compensation.[695]

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[688] Austin and Ramsay op cit note 36 at 1441; Guidance Note 1.
[689] Strine op cit note 229.
[690] Ibid.
[691] ASIC Act 2001 (Cth); Corporations Act 2001 (Cth).
[692] Guidance Note 12.
[693] Saulsbury op cit note 10 at 135-136.
[694] Hertig and McCahery op cit note 683 at 562.
[695] Weinberg and Blank op cit note 9 at 18; Sutherland op cit note 3 at 90-91; Phakeng op cit note 255 at 53.

It is not so simple for directors to entrench themselves any longer.[696] In terms of the 2008 Companies Act they can be removed by a simple majority, therefore, at first glance, this makes that argument moot in South Africa.[697] However, studies have shown that shareholders rarely make use of their power to remove directors.[698] This is connected to shareholder apathy.[699] It illustrates that further measures are required to ensure that the board does not abuse its power.

In the US the problem of entrenchment is different: due to the staggered board system.[700] It was mentioned that during a hostile bid proxy contests are used to oust a target board but these contests are rare due to the costs.[701] Therefore, there is no real threat of removal and the safety mechanisms are notably deficient.[702]

In terms of the 2008 Act the board manages the company therefore they are more informed than shareholders and as a result would probably make better decisions.[703] In managing the company the board must fulfil its fiduciary duties, the fundamental one being to make decisions in the best interests of the company.[704] The 'company', as discussed, refers to the shareholders of the company.[705] The fiduciary duty of directors indicates that the interests of the board members are similar, unlike shareholders who, do not owe a fiduciary duty towards the company and have differing interests.[706] There is a check and balance in place for directors as their decisions are subject to their fiduciary duty, however, there is no such balancing provision for the decisions of

[696] Companies Act 71 of 2008 s71; Companies Act 61 of 1973 s220.
[697] Section 71(1).
[698] Bebchuk op cit note 484 at 239; Sutherland op cit note 3 at 89.
[699] Cahn and Donald op cit note 76 at 798; Christison and Williams op cit note 91 at 792.
[700] Davids, Norwitz and Yuill op cit note 8 at 339-340.
[701] Barry and Hatfield op cit note 69 at 643-644; Palmiter op cit note 60 at 735; Bebchuk op cit note 484 at 239.
[702] Bebchuk op cit note 484 at 241.
[703] *Aronson* supra note 261 at 811; Boardman op cit note 13 at 333.
[704] Sutherland op cit note 3 at 84.
[705] Ibid at 84; F Cassim op cit note 234 at 20; F Cassim op cit note 285 at 515.
[706] Sutherland op cit note 3 at 91; Schuitema op cit note 271 at 14.

shareholders.[707] Also, South Africa practises the stakeholder inclusive approach which ensures that when making decisions the board takes the interests of all stakeholders into account to the extent that it is in the best interest of the company and the term 'company' generally refers to shareholders.[708] This, coupled with the fear of removal will ensure that shareholder interests are serviced by the board.[709]

In conclusion therefore I have aimed to rebut the two main arguments against the board being given the power to decide the outcome of a bid.[710] To summarise, the first standpoint with regard to entrenchment is countered by the argument that directors cannot easily entrench themselves under the 2008 Act.[711] With regard to directors compensation, the board has a fiduciary duty to make decisions in the best interests of the company therefore the compensation could breach their fiduciary duties.[712] This also encapsulates two of the safety mechanism that would make it preferable for the board to make decisions as to frustrating action, first their fiduciary duty and second, that they can easily be removed.[713]

The third safety mechanism is built into the Act and provides that only independent directors of a target board can participate in decision making and voting.[714] It does not provide what an independent director is but rather states what a non-independent director is and creates a rebuttable presumption in each circumstance.[715] For example, there is a rebuttable presumption that a director who is on the board of the target and the acquiring firm is a non-independent director.[716] Also, the Act provides that the target

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[707] Levitt and Bee op cit note 6 at 41; Saulsbury op cit note 10 at 135-136.
[708] King III Report on Corporate Governance Principle 8.1.1; F Cassim op cit note 285 at 515.
[709] Kley op cit note 64 at 6, 8; Matsaneng op cit note 53 at 142.
[710] Weinberg and Blank op cit note 9 at 18; Sutherland op cit note 3 at 90-91; Phakeng op cit note 255 at 53.
[711] Section 71.
[712] Companies Act 71 of 2008 s71; R Cassim op cit note 333 at 441; Sutherland op cit note 3 at 84, 90-91; Weinberg and Blank op cit note 9 at 18; Phakeng op cit note 255 at 53.
[713] Bebchuk op cit note 484 at 239; Sutherland op cit note 3 at 96-97.
[714] Regulation 108(5)*(a)*; Cassim and Yeats op cit note 9 at 744; Sutherland op cit note 3 at 96.
[715] Regulation 108(5)*(a)*.
[716] Regulation 108(8)*(a)*.

board must obtain advice from an independent expert when considering an offer.[717] It must take cognisance of this advice when providing its opinion to the shareholders.[718] This attempts to ensure that decisions of the board are well informed and that they remain unbiased.[719]

Should South Africa have a Common Law Regime?

Delaware takeover law uses a common law system that has many benefits.[720] First, one that applies in general when law is regulated via common law is the gradual and natural development of the law.[721] It allows the users of the law to adjust.[722] The overarching advantages in relation to this particular area of law is that it allows the law to keep up with the times ('market demands')[723] and as a result it allows flexibility.[724] The board is able to consider all the surrounding circumstances in order to determine what will be in the best interests of the company and its shareholders.[725]

The major disadvantage is that the Delaware courts have applied their takeover law inconsistently.[726] This inconsistency breeds legal uncertainty.[727] It is a major flaw, however, if imported into a different legal system, like South Africa, it can be used with the knowledge of lessons learnt by the Delaware system and our courts can apply their minds consistently.[728] The inconsistency in the Delaware system could also be attributed to the fluctuating nature of commerce.[729] Also, that inconsistency could also

717 Regulation 110(1).
718 Regulation 110(2).
719 Cassim and Yeats op cit note 9 at 744.
720 Strine op cit note 229.
721 Bebchuk op cit note 484 at 256.
722 Ibid.
723 Hertig and McCahery op cit note 683 at 551.
724 *Barkan v. Amsted Indus., Inc.,* 567 A.2d 1279, 1286 (Del. 1989).
725 Saulsbury op cit note 10 at 128.
726 Matsaneng op cit note 53 at 156-157.
727 Ibid; *Paramount Communications* supra note 534 at 1153.
728 Ibid.
729 Strine op cit note 229.

be a problem for a Takeover Panel.[730] The Australian Guidance Note provides reassurance that the Panel has knowledge of what is relevant.[731] In a more recent takeover regime as that in South Africa this guidance and reassurance is even more crucial to instil faith in the regime of those who must use it.[732]

As previously discussed, there is a significantly higher incidence of derivative proceedings in the US than in the UK.[733] Due to this the shareholders in the UK do not fulfil the 'controlling mechanism' role to the extent that the shareholders in the US do.[734] The US is known to be a litigious nation, South Africa, not to the same extent, for this reason the common law system may not be appropriate.[735]

South Africa and the UK have a similar system, this is due largely to the fact the South African takeover regime is based on that of the UK.[736] The systems are based on hard and fast, bright line rules.[737] The advantage in this regard, is clear, it provides legal certainty.[738] This translates into a reduction in legal fees because parties will not, for example, have to consult as to a particular position in the law.[739] The UK takeover rules 'appear both more complete and focused'[740] than those of Delaware.[741]

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730 The Takeover Panel in the UK and South Africa was previously discussed.
731 McConvill op cit note 592 at 189.
732 Olson op cit note 517 at 247.
733 Saulsbury op cit note 10 at 121.
734 Hertig and McCahery op cit note 683 at 558.
735 Boardman op cit note 13 at 333.
736 Wiblin op cit note 105 at at 177-178; Stein op cit note 20 at 333.
737 Saulsbury op cit note 10 at 116.
738 Stein op cit note 20 at 333.
739 Armour and Skeel op cit note 142 at 1748.
740 Cahn and Donald op cit note 76 at 770.
741 Ibid.

Permissible Preventative Action

The non-frustration rules found in the South African Companies Act gives the impression that there is nothing that a target board would be able to do when faced with a hostile bid.[742] I will discuss whether the permissible defences used in the UK, as discussed above, are plausible for South Africa, considering that the regimes are similar.[743]

In South Africa, directors have invoked competition law as a backdoor defence.[744] It has been argued that in order for the non-frustration rule to have full force, competition law and company law must be reconciled.[745] Harmony Gold Limited attempted a hostile takeover of Gold Fields Limited; however, Gold Fields resisted it in terms of the Competition Act in what has loosely been referred to as the 'competition card'[746] by applying for an interdict to stop the takeover as there was a lack of compliance with the Competition Act.[747] Ultimately, the Competition Appeal Court granted the interdict.[748]

In South Africa the 'defence document' is known as an 'offeree response circular'.[749] The purpose is to provide the shareholders of the target company with all the relevant information and the view of the board on the proposed offer.[750] It must contain an array of information including whether the board accepts or rejects the offer and whether individual directors will vote for or against the offer in relation to their own relevant securities.[751] The circular is essentially a document containing information which is

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742 Sutherland op cit note 3 at 96.
743 Wiblin op cit note 105 at 177-178.
744 Christison and Williams op cit note 91 at 794.
745 Sutherland op cit note 3 at 97.
746 Christison and Williams op cit note 91 at 795.
747 Ibid.
748 *Gold Fields Limited v Harmony Gold Mining Company Limited* Unreported Case no.43 / CAC / Nov 04.
749 Regulation 106(7); Prentice and Holland (eds) 'Table of Frequency' (1993) *Contemporary Issues in Corporate Governance* 141 as cited by Robinson op cit note 96 at footnote 197.
750 Regulation 106(7)*(a)*.
751 Regulation 106(7)*(i)*.

published by the company to the holders of its securities.[752] With regard to the white knight defence, it is submitted that due to the anti-avoidance provisions that this would not be possible in South Africa, it would reduce the very purpose of the general principle against frustrating action contained in s119.[753]

Derivative Action

This derivative action used as a remedy in the UK and the US can also be found in s165 of the 2008 Act.[754] The 2008 Act has revoked the common law derivative action and replaced s266 of the 1973 Act.[755] The derivative action can be brought by someone else in the name of the company for the purposes of protecting the 'legal interests' of the company.[756] The term 'legal interests' is not defined in the 2008 Act.[757] It is quite broad and thus allows more protection for the company and in essence then the minority shareholders.[758]

The purpose for which the derivative action exists in South Africa is the same as that of the US- if the management of the company does not institute an action then the shareholders may.[759] When bringing the action the shareholder asserts that the negligence of mismanagement by the board resulted in the company suffering economic injury.[760] It is indirectly used as a method to enforce the fiduciary duties of directors.[761]

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752 Cassim and Yeats op cit note 9 at 744.
753 Section 6; s119.
754 Coetzee op cit note 171 at 298.
755 Section 165.
756 Section 165(2).
757 Coetzee op cit note 171 at 298.
758 Ibid.
759 *Aronson* supra note 261.
760 Ibid.
761 Saulsbury op cit note 10 at 120.

In the UK, the percentage of hostile takeovers challenged using the derivative action is drastically lower than in the US.[762] This is so for a number of reasons, mainly because derivative actions are simply more lucrative for legal professionals in the US to bring,[763] also, the UK has a statutory authority system in place whereas the US does not.[764] Statute provides certain remedies and consequences.[765] Between 1990 and 2005, 33.9 per cent of hostile takeovers in the US were challenged using the derivative action.[766] In the UK the figure is 0.1 per cent.[767]

Its is submitted that there is no reason why the derivative action cannot be used in the same way in South Africa, especially with the introduction of the term 'legal interests' widening the ambit of matters that can be brought in terms of the remedy.[768] In any event, a shareholder is of the listed people that can make an application in terms of the Act.[769]

Summary

The regime in South Africa is strict in comparison to that of the UK, US and Australia.[770] Understandably, the history and economic climate differs to that of its first world comparatives.[771] However, South Africa should look to these countries as examples.[772]

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762 Ibid at 121.
763 Saulsbury op cit note 8 at 121; Armour and Skeel op cit note 142 at 1744-1745.
764 Armour and Skeel op cit note 142 at 1744-1745.
765 Ibid.
766 Ibid at 1748 (Table 2).
767 Ibid.
768 Coetzee op cit note 171 at 298.
769 Section 165(2)*(a)*.
770 This has been fully discussed. In the US defensive measures are commonplace. In Australia it is allowed but frowned upon. In the UK defensive measures may be taken with shareholder approval. In South Africa approval is required from shareholders and the TRP.
771 Matsaneng op cit note 14 at 29.
772 Ibid.

It is submitted that the US culture of defensive mechanisms would not be appropriate in our context but also that a limited degree should be possible depending on the circumstances, like Australia.[773] For the various reasons elaborated on above, it is submitted that the ultimate decision should not lie with the shareholders but instead with the directors as there are sufficient checks and balances to ensure that the drawbacks of allowing directors to decide are adequately managed.[774] Also, there is sufficient protection for shareholders in the 2008 Act.[775] The framework used in South Africa is commendable but it is submitted that a more flexible regime would be better suited.[776]

[773] Saulsbury op cit note 10 at 128; Boardman op cit note 13 at 333.
[774] This is fully discussed at 75-78.
[775] For example s163, s164 and s165; Boardman op cit note 13 at 312, 333.
[776] Matsaneng op cit note 14 at 29.

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