

University of Cape Town

Faculty of Law – School for Advanced Legal Studies

**SHAREHOLDER APPRAISAL RIGHTS IN SWAZILAND- SUGGESTIONS FOR
LEGISLATIVE REFORM**

A

Minor LLM Dissertation

by

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Research dissertation presented for the approval of Senate in fulfilment of part of the requirements for the Masters in Commercial law in approved courses and a minor dissertation. The other part of the requirement for this qualification was the completion of a programme of courses.

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

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DEDICATION.

This dissertation is dedicated to my son Aphiwe Andile Edward Mathabela and to the memories of my mother Mrs. Mavis Thembi Malinga and brother Mr. John Thamsanqa Mathabela.

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I would like to thank my family for the unwavering love and support given to me over the years. I would also like to thank my friends for the support and words of encouragement which kept one sane in times of need. Lastly, I would like to appreciate all the good people who have made life more meaningful to me. Thank you.

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INTRODUCTION

As a general rule in company law, the business of the company is conducted based on the votes of the majority of shareholders in that company. In certain instances however, the majority might take decisions that are detrimental to the minority shareholders of the company and therefore it is imperative that any company legislation has significant protective measures for minority shareholders in place.

This paper will discuss the concept of minority shareholder protection. This paper will do a comparative study between the shareholder appraisal regimes in the United States, Canada and South Africa. Since appraisal rights do not exist in Swaziland, a comparative study of minority shareholder protection in the United Kingdom will also be undertaken because Swaziland was colonised by the British and as such most of its law is rooted in English Law. It is from this lens that this paper will then examine minority shareholder protection in Swaziland.

The research question addressed by this dissertation is two-fold. The first part of the question analyses the current measures in place for minority shareholder protection in Swaziland in comparison to measures that other jurisdictions have in place for the protection of minority shareholder rights. The second part looks at what the ideal shareholder appraisal rights law in Swaziland should contain in light of the current legislation as a means to make it more easily accessible to minority shareholders.

The purpose of the dissertation is not to recommend a wholesome transplant of shareholder appraisal rights of either one of the jurisdictions under discussion, but to highlight the best practices of the jurisdictions and suggest a shareholder appraisal rights law that best suits the Swaziland business and economic environment.

The dissertation is divided into eight Chapters. Chapter one is the introduction. Chapter two will discuss the history of the appraisal remedy and the underlying philosophy behind the remedy. Chapter three will discuss the underlying rationale for the introduction of the appraisal remedy into South African company law. Chapter four will discuss the appraisal procedure contained in section 164 of the South African Companies Act 71 of 2008 as well as the requirements that minority shareholders have to comply with before invoking the appraisal remedy. Chapter five

discusses the effectiveness of the appraisal remedy as a form of minority shareholder protection. Chapter six will discuss minority shareholder protection in the United Kingdom including current legislative procedures in place. Chapter seven will examine minority shareholder protection in Swaziland including discussing the current legislative procedures in place. The discussion on minority shareholder protection in light of these seven chapters will be concluded in Chapter eight and recommendations on better minority shareholder protection in Swaziland will be made.

As a means to facilitating the creation of business combinations, promoting flexibility and enhancing efficiency in the South African economy and reducing the opportunities for regulatory arbitrage, the legislature liberalised the fundamental transactions policy under the Companies Act 71 of 2008 ('the Act'). Although the Act does not define the phrase 'fundamental transactions', these are transactions that alter a company and comprise of: a disposal of all or the greater part of the assets or the undertaking of a company;¹ an amalgamation or merger;² and a scheme of arrangement.³

The revision of the Act has introduced two major reforms firstly; the innovative American concept of amalgamations and mergers (M & A) which is also referred to as the 'statutory merger'. The statutory merger is in essence a simple, uncomplicated and effective procedure whereby the assets, liabilities and sometimes shareholders of two or more companies ('merging companies') are combined together; resulting in one or more of the combining companies ('the surviving company') or newly formed company ('the new company'). It should be noted that For the merger/ amalgamation to be authorised, it has to be approved by a special resolution of the company's stakeholders.

Secondly, the Act introduced the remedy of appraisal rights for dissenting shareholders which is a remedy that gives dissenting shareholders the right to 'opt out' of the company by being paid the fair value for their shares in cash. The court's

¹ Section 112.

² Section 113.

³ Section 114.

involvement in this instance is restricted to certain specified circumstances.⁴ The liberalised nature of the fundamental transactions policy makes minority shareholders vulnerable to abuse and domination by majority shareholders because it negates the shareholders vested right/ shareholding right.⁵ Further, it adopts an approach that holds the interests of the shareholders subject to the judgement and decisions of the collective majority.⁶

As an offset to the effect that the liberalisation of the policy might have on minority shareholders who disapprove of a fundamental transaction, the South African legislature introduced an appraisal remedy which is a non-fault remedy that gives the dissenting shareholders the right to 'opt out' of the company by receiving an amount of money in cash for the fair value of their shares, by invoking the appraisal remedy.

Many scholars have acknowledged the appraisal remedy as the primary protective remedy for minority shareholders in fundamental transactions. However, the appraisal remedy is viewed by dissidents as being ineffective in its current form due to its complicated procedures, technicalities and procedurally rigid procedures. The complexities of the appraisal remedy are time consuming and are costly to the dissenting shareholder, which in turn limits the efficiency of the appraisal remedy and the appraisal remedy becomes less appealing to the minority shareholder as recourse.⁷

In my view, although certain provisions of the appraisal remedy are too limiting and thus ineffective in its current form, through simplification of its procedures, the appraisal remedy has the potential of becoming 'the primary protective remedy of minority shareholders' and only then will this remedy be more accessible to minority shareholders who seek to use it; as the excessive costs and time consuming implications would/ could be greatly reduced.⁸ This in effect would allow the remedy

⁴ Where the company has failed to make an offer at all to the minority shareholder for the acquisition of his shares or if the company has made an offer that is considered by the minority shareholder to be inadequate.

⁵ M F Cassim 'The Introduction of the Statutory Merger in South African Corporate Law: Majority Rule Offset by the Appraisal Right (Part 1)' (2008) 20 SA Merc LJ 1 at 21-2.

⁶ Ibid.

⁷ F H I Cassim, M F Cassim, R Cassim, R Jooste, J Shev & J Yeates *Contemporary Company Law 2* ed (2012) 798.

⁸ B L Nicol *The Effectiveness of the Appraisal Right as a Form of Shareholder Protection* (Unpublished LLM thesis, University of Cape Town, 2014) 2.

to counter the liberalisation of fundamental transactions policy thus strike a fairer balance between the interest of minority and majority shareholders.⁹

In Swaziland, on the other hand, the legislature is lagging behind regarding legislating for the protection of minority rights; minority shareholder protection exists however a comprehensive appraisal law does not exist and dissenting shareholders find themselves being bound by the decisions of the majority with no option to 'opt out' of the company.

⁹ Ibid.

II THE ORIGINS OF THE APPRAISAL RIGHT AND ITS PURPOSE

The appraisal remedy is an American innovation and has been in existence for over a century although, no consensus has been reached with regards to its primary purpose and role in modern corporate law.¹⁰ It is worth noting that currently, all fifty states in the United States provide for an appraisal remedy in one form or another and despite the differing legislation amongst states, shareholders are afforded the right to be paid out in cash the fair-value of their shares, on the occurrence of certain triggering actions for a price equal to the value of the shares.¹¹

Historically, mergers and other fundamental transactions in the United States of America required the unanimous approval of all the shareholders of a company for the fundamental transaction to commence. In order to promote commerce and trade, corporate statutes were amended to adapt to the ever-changing corporate regime and to allow companies to engage in fundamental transactions without the need for a unanimous shareholder approval; rather the majority of shareholders sufficed.

Consequently, individual and minority shareholders were not able to veto fundamental company transactions thus the appraisal remedy was granted to shareholders to compensate for the loss of that veto power.¹² Generally, it has been agreed that the appraisal remedy served as a *quid pro quo* for the loss of shareholders right to veto fundamental company transactions. Further, the appraisal remedy became a liquidity rationale because it provided dissenting shareholders a mechanism to exit the company.¹³

Originally, the consideration in mergers was limited to securities and not extended to a cash consideration, thus the appraisal remedy was justified as an exit mechanism

¹⁰ B M Wertheimer 'The Purpose of the Shareholders' Appraisal Remedy' (1997-1998) 65 *Tennessee Law Review* 661 at 661-62.

¹¹ Under the Model Business Corporation Act (MBCA or Model Act), the following events trigger the availability of the appraisal remedy: 1) consummation of a plan of merger; 2) consummation of a plan of share exchange; 3) consummation of a sale or exchange of all, or substantially all, of the property of the corporation outside of the usual and regular course of business; and 4) certain amendments to the corporation's articles of incorporation. B M Wertheimer 'The Shareholder's Appraisal Remedy and How Courts Determine Fair value' (1998) 4 *Duke Law Journal* 613 at 616.

¹² Wertheimer op cit note 10 at 662.

¹³ M F Cassim 'The Introduction of the Statutory Merger in South African Corporate Law: Majority Rule Offset by the Appraisal Right (Part 2)' (2008) *SA Merc LJ* 20 at 158.

and dissenting minority shareholders who objected to a merger were entitled to receive the fair value of their shares in cash and relinquish their positions in the respective company.¹⁴ Without this remedy, dissidents would have been forced to be party to investments they did not want to be a part of; with a risk profile they would not have accepted.¹⁵ This is known as the 'defeated expectations' view, which entitles shareholders the liberty to own shares in companies that they desire and not to be bound as a result of a merger, to hold shares in investment(s) different from what they had initially sought to invest in.¹⁶

Subsequently, the regulation of corporate transactions was relaxed and cash was permitted as consideration in mergers. The modern justification for the appraisal remedy is the protect minority shareholders from being inadequately priced and to ensure that they receive a fair value for their shares in a company.¹⁷ This phenomenon is known as the 'remedy-for-unfairness' justification and it is premised upon the fact that directors negotiate the business terms of the merger; and can easily neglect their duty to secure the highest price, to the detriment of the shareholders. Thus, the appraisal remedy also functions as a deterrent to directors from making bad business decisions that would affect the dissenting shareholders' interests in the business, adversely in that the greater the number of dissenting shareholders the higher the possibility of the board reconsidering the transaction.¹⁸

The three main objectives of the appraisal remedy are that it provides a conducive market for mergers; provides liquidity to dissenting shareholders; and serves as a deterrent from opportunism by the directors and the majority shareholders of the company.¹⁹ The appraisal remedy therefore strikes a balance between the need for companies to be managed based on the majority vote with the need to protect the minority against being involuntarily dragged along into a drastically restructured enterprise in which it has no confidence'.²⁰

However, if the proposed fundamental transaction i.e. a merger does not result in a cash flow shortage and complies with the requisite proper formalities for paying out

¹⁴ Ibid.

¹⁵ Ibid.

¹⁶ Ibid.

¹⁷ Ibid.

¹⁸ Ibid.

¹⁹ Ibid at 159.

²⁰ Ibid.

the dissident shareholders; the majority shareholders may still effect almost any transaction with impunity.²¹ Thus the appraisal remedy is recourse that is at the disposal of the minority shareholders, to protect them from discrimination while preserving the flexibility that is required for changing business conditions.²²

The appraisal remedy is contentious and has generated much controversy in relation to the fundamental changes it introduced. For instance Manning discusses how the appraisal remedy ought to apply and he questions the arbitrary selection of certain transactions, which state legislatures in the United States have selected for special treatment.²³ He argues in his survey of state appraisal statutes by transactions that statutes of North Carolina and Louisiana²⁴ are comparable, as states that provide for the appraisal remedy in circumstances similar to the Companies Act.²⁵

It is important to note that the appraisal remedy has evolved from being a remedy available to protect the interests of dissident shareholders when they exit a company to giving 'greater mobility of action to the majority'.²⁶ As pointed out by Manning, 'the appraisal statutes may be viewed either as a bulwark for the rights of the minority, or as a lubricant to speed the spread of majoritarianism. Of course the statutes might do both, depending upon their administration and their application'.²⁷

These observations seem to have been correct because in 1994, the American Law Institute's corporate governance project summarised US corporate law as a 'largely unqualified system of majoritarian control'.²⁸

²¹ A Pike *A Textual Analysis of Section 164 of the Companies Act 71 of 2008* (Unpublished LLM thesis, University of Cape Town, 2013) 7.

²² *Ibid.*

²³ B Manning 'The Shareholder's Appraisal Remedy: An Essay for Frank Coker' (1962) 72 *Yale Law Journal* 223 at 226 - 227.

²⁴ *Ibid* at 264.

²⁵ No 71 of 2008.

²⁶ Manning *op cit* note 24 at 227.

²⁷ Manning *op cit* note 24 at 230.

²⁸ American Law Institute *Principles of Corporate Governance: Analysis and Recommendations* (1994) 291.

III THE APPRAISAL RIGHT IN SOUTH AFRICA AND ITS PURPOSE

As stated earlier, the appraisal remedy is a new phenomenon in South African law that has been adopted from the United States of America's corporate law and may best be described as a right of dissenting shareholders who do not approve of any triggering events to have their shares bought out by the company in cash, at a price reflecting the fair value of the shares; value, which may in certain cases be determined judicially.²⁹

Fundamental company transactions have a major impact on society: they play an integral role in the efficient distribution of a society's resources and it involves matters of public interest and policy.³⁰ Companies established under modern company legislation are considered democratic organisations but are subject to majority rule. As a result, minority shareholders are vulnerable to manipulation and exploitation by the majority. For example, majority shareholders may take decisions that have the short-term effect of decreasing the price of a company's shares in order to acquire the minority's interest in the company at low price.³¹ The appraisal remedy therefore purports to strike a balance between encouraging economic activity and protecting the interests of the company's shareholders.³²

Section 164³³ governs the appraisal remedy under the South African corporate law and a large part of it is derived from the equivalent provision in the Canadian Act.³⁴ This section was introduced to strike a balance between a) the newly adopted newly adopted fundamental transaction and b) enhance efficiency in the economy.³⁵

The appraisal remedy is not a general right and it can be invoked under two circumstances namely, where the company gives notice to its shareholders that it proposes to pass a special resolution to: (a) amend its Memorandum of

²⁹ Cassim op cit note 51 at 21-22.

³⁰ E Davids, T Norwitz & D Yuill 'A microscopic analysis of the new merger and amalgamation provision in the Companies Act 71 of 2008' in T H Mongalo (ed) *Acta Juridica: Modern Company Law for a Competitive South African Economy* (2010) 337.

³¹ Wertheimer op cit note 10 at 661-662.

³² Davids op cit note 30 at 338.

³³ The Companies Act 71 of 2008.

³⁴ Canada Business Corporations Act RSC 1985, c. C-44 s190.

³⁵ Notice of intention to introduce a Bill into Parliament: Explanatory summary of Bill General Notice 166 of 2007 at 13.

Incorporation by altering the preferences, rights, limitations or other terms of any class of its shares, in any manner materially adverse to the rights or interests of holders of that class of shares, as contemplated in section 37 (8) ³⁶; (b) enter into a transaction contemplated in sections 112, 113 or 114.³⁷

The transactions contemplated in sections 112, 113 and 114 are transactions that involve the disposal of all or the greater part of the assets or the undertaking of a company. Further, the transactions that are entered into by a company under the transaction of amalgamation or merger or a scheme of arrangement are commonly known as fundamental transactions. In cases where the transaction is not part of a business rescue plan, the company must first give notice to the shareholders of a meeting whereby a resolution, pursuant to a fundamental transaction will be considered for adoption.

The appraisal remedy is a no-fault remedy and when it is granted, it is acknowledged that the fundamental transactions may have significant and far-reaching consequences for shareholders.³⁸ When the appraisal remedy is granted, it is indicative that the nature of the company and the rights of the shareholders could be drastically altered.³⁹ In the absence of general court involvement, the remedy has become the primary protective remedy for minority shareholders of companies that are involved in fundamental transactions. The remedy gives the minority shareholder a right to 'opt out' of the company by receiving a fair value of their shares in cash.

In order to strike a balance between providing flexibility for the majority shareholders, to enable them to modify the company and alter investor's rights as a means to adapt to the ever changing business environment, and the need to protect minority shareholders' rights; fundamental transactions operate in the interests of flexibility subject to majority rule.⁴⁰ As a *quid pro quo*, the dissenting minority shareholders are granted the appraisal remedy as an exit strategy, thus the remedy is one that

³⁶ Section 164 (2) (a) of Companies Act 71 of 2008.

³⁷ Section 164 (2) (b) of Companies Act 71 of 2008.

³⁸ Cassim et al op cit note 7 at 796.

³⁹ Ibid.

⁴⁰ Cassim et al op cit note 7 at 796-797.

balances the rights of the majority shareholders with those of the minority shareholders.⁴¹

The appraisal remedy has three main objects: firstly, it is traditionally justified as an exit strategy for dissenters, it gives them the right to 'opt out' of the company by receiving an amount in cash for the fair value of their shares through the exercise of their appraisal remedy.⁴² Without the appraisal remedy, dissenting shareholders would otherwise be forced to be shareholders in a company they did not want to invest in, with a risk profile they had not accepted.

The second object of the remedy is that it is perceived as a vital remedy for unfairness and gives the dissenter the right to approach the court to challenge the value in cash that is offered for the shares.⁴³ The third object is that the appraisal remedy serves as a deterrent to directors, from making bad business judgments and the greater the number of dissenting shareholders invoking the appraisal remedy, the greater the likelihood the board of directors might reconsider the implementation of that transaction.⁴⁴

It must be stated that from the perspective of the company, the obligation to purchase the appraised shares may drain the company's liquidity which may result in the abandonment of the proposed fundamental transaction which could have been favourable for the company.⁴⁵ In addition, shares that have been surrendered to the company in the exercise of the appraisal remedy become shares that are authorised but not issued⁴⁶, and they become cancelled, as the company is barred from holding them as treasury shares.

Before invoking the appraisal remedy, the dissenting shareholders must perfect the appraisal remedy by complying with a complex appraisal procedure, as set out in Section 164 of the Companies Act (South Africa).

First, the shareholder must send a written notice to the company objecting to the resolution when that shareholder is made aware of the resolution that is being

⁴¹ Ibid at 797.

⁴² Cassim et al op cit note 7 at 797.

⁴³ Ibid.

⁴⁴ Ibid.

⁴⁵ Manning op cit note 24 at 241.

⁴⁶ Section 35 (5) of Companies Act 71 of 2008.

considered for adoption.⁴⁷ Secondly, once the proposed resolution has been adopted, the dissenting shareholders must submit a written demand to the company for the fair value of their shares. Thirdly, the resolution that has been adopted must have been supported by at least seventy-five percent of the shareholders entitled to vote at a meeting specifically called for that purpose.⁴⁸ Fourthly, the shareholder must have voted against the resolution when it was considered for adoption.⁴⁹ Lastly, the shareholder must have complied with all the procedural requirements as stated in section 164 of the Companies Act.

After the perfection of the appraisal remedy requirements by the dissenter, the company must make an offer to pay the dissenter an amount in cash that is considered by the directors to be fair value of the shares. The value of the shares should be determined immediately before the company adopts the resolution.⁵⁰ Should the dissenter deem that the company's offer for the shares is not adequate or the company did not make an offer at all, the dissenter is entitled to apply to court for the fair determination of the value of the shares.

The appraisal remedy can also be invoked by shareholders of listed companies despite the fact that those dissenters can sell their shares on the open market and this is permitted because financial markets are said to be notoriously imperfect. In contrast, some states in the USA provide for a market exception which excludes the availability of the appraisal remedy in respect of shares that have a reliable value and are traded in a liquid market.⁵¹

One of the major advantages of the appraisal remedy is that it is not court driven and the court only intervenes at the very end of the appraisal procedure, when there are some disagreements.⁵² The mandatory steps to perfect the appraisal right are considered below.

⁴⁷ Section 164 (3) of Companies Act 71 of 2008; at any time before the resolution referred is to be voted on.

⁴⁸ Section 115 (1) read with section 115 (2)(a) of Companies Act 71 of 2008.

⁴⁹ Section 164 (5) (c) (i) of Companies Act 71 of 2008.

⁵⁰ Cassim et al op cit note 7 at 797.

⁵¹ Cassim op cit note 13 at 162.

⁵² Cassim et al op cit note 7 at 798.

IV THE APPRAISAL PROCEDURE

Before the appraisal remedy can be invoked, the dissenting shareholders must satisfy the appraisal remedy requirements by complying with a complex appraisal procedure as set out in section 164.⁵³ The appraisal procedure will be discussed in greater detail below.

(a) Statement of appraisal rights

Section 164 of the Act does not create an obligation on the company to give the meeting notice where the proposed resolution to adopt the transaction will be taken however, section 164 (2) does compel the company to include in the notice for the meeting, a statement informing shareholders of the appraisal remedy. The aim is to ensure that dissidents are aware of their right to invoke the appraisal remedy and seek relief that is available in relation to triggering events.

The notice requirements are provided for under these sections: s112(3) requires 'a *written summary* of the provisions of section 164'. Section 113(5) requires 'a *copy or summary* of section 164, in a manner that satisfies prescribed standards'. Section 114 requires 'a *copy* of section 164 to be included in the report and since there is no prescribed standard, the copy or summary must be in plain language.⁵⁴ Due to the inconsistencies in terminology in the above mentioned sections regarding what constitutes a statement informing shareholders of the appraisal remedy, it is recommended that a meeting notice should include a copy and a summary of s164 to avoid constituting a material defect as contemplated in ss 62(4) and 62(5).

In relation to the requirement to include the appraisal remedy statement in the meeting notice, a Canadian court in the case of *Fitch v Churchill Corp*⁵⁵ held that a notice which simply state that 'the Act provides that a shareholder has a right to dissent if the corporation resolves to amend its articles' will not suffice. The Canadian Act refers to a notice that includes at least an explanation of all the rights

⁵³ Companies Act No 71, 2008.

⁵⁴ Section 6 (5).

⁵⁵ [1990] 4 WWR 256, citing the Business Corporations Act SA 1981 c B-15.

afforded to dissidents, including the right to be paid for the shares in the event of a structural change to the constitutional documents of the company being the most critical.⁵⁶

(b) Notice of objection by dissenting shareholder

Section 164 (3) provides that a dissenting shareholder may notify the company through written notice that he objects to the proposed resolution. The written notice must however be given at any time prior to that resolution being voted on. Although this section states that a notice of objection 'may' be given, giving notice is one of the essential prerequisites for the exercise of an appraisal remedy as stated in sections 164 (5), 37 (8) and 115 (8); and failure to submit written notice may result in the dissenter losing the right to invoke and use the appraisal remedy, as one requirement would be lacking.⁵⁷ As soon as dissenting shareholders are made aware of a triggering event being proposed for adoption, they are advised to immediately submit a written notice objecting to its adoption before the resolution is passed.

The written notice requirement may be excused only under the following two instances: firstly where the company failed to include a statement of the shareholders appraisal rights in the notice of the meeting; secondly, where the company failed to give notice of the meeting.⁵⁸ If the statement of the appraisal remedy is made but does not satisfy the definition of 'plain language' as provided for in section 6(5), the statement will be defective. This will consequently, constitute a failure to include a statement of the s164 rights; thus giving rise to a valid exception in terms of section 164(6).⁵⁹

The rationale behind the dissenting shareholders providing the company with written notice of their objection, prior to the meeting, is to make the company aware of the number of dissenters, giving the company an opportunity to estimate the amount of cash payment that it could be required to pay when the appraisal remedy is invoked. Appraisal demands have the potential of impacting negatively on the monetary

⁵⁶ Section 190 (5) Canadian Business Corporations Act, 1985.

⁵⁷ Cassim et al op cit note 7 at 800.

⁵⁸ Section 164 (6) of Companies Act 71 of 2008.

⁵⁹ Nicol op cit note 8 at 21.

resources of a company that would be obliged to purchase the appraised shares thus it assists the company to be pre-emptive in this regard.⁶⁰

If a large number of shareholders intend dissenting, the board may reconsider its decision to proceed with the fundamental transaction before it is voted on by the shareholders in the meeting. A resolution may subsequently be revoked even after it has been adopted.⁶¹ It must be stated that where the company revokes the resolution, the dissidents' right to an appraisal falls away as there is no longer a transaction on which to dissent.

Further, the appraisal remedy is only available to shareholders who are entitled to vote on the relevant resolution and does not extend to shareholders who are debarred from voting on resolutions in terms of s115(4), nor to shareholders who do not hold any voting rights.

(c) Notice of adoption of the resolution

The company must, within ten business days after adopting a fundamental transaction resolution, send notice of the adoption to each shareholder who gave the company written notice of objection and who has not withdrawn that notice nor voted in support of the resolution.⁶² Failure by the company to provide such notice, within the ten business days, does not result in adverse legal consequences against it but it may have practical consequences for example, delays in the delivery of demands by dissenting shareholders to the company.⁶³

(d) Demand by dissenting shareholder

Before a dissenting shareholder may be entitled to demand that the company pay the fair value for all the shares of the company held by him/her, the shareholder must 'perfect' the appraisal right by satisfying the following procedural requirements:⁶⁴ (a) the shareholder must have sent the company a notice of objection, subject to the

⁶⁰ Ibid.

⁶¹ Section 164 (9) (c) of Companies Act 71 of 2008.

⁶² Section 164 (4) of Companies Act 71 of 2008.

⁶³ Cassim et al op cit note 7 at 801.

⁶⁴ Section 164 (5) of Companies Act 71 of 2008.

exceptions listed in section 164 (6); (b) The company must have adopted the contemplated resolution; and (c) The shareholder must have voted against that resolution in the meeting and complied with all of the procedural requirements of section 164.

The demand should be made by delivering a written notice to the company within 20 business days after receipt of a notice of adoption of the resolution⁶⁵, or within 20 business days after learning that the resolution has been adopted.⁶⁶ The demand must also be delivered to the Takeover Regulation Panel⁶⁷ and should contain the details set out in Section 164 (8).⁶⁸

Canada uses a similar procedure whereby it is only after the resolution is passed that the dissident must provide the number and class of shares in respect of which he dissents by way of demand. However, section 190 (7) of the Canadian Act does not set a fixed deadline upon which the letter of demand ought to be submitted to the company.⁶⁹ In the case of South Africa, this requirement is problematic.

A dissenting shareholder who has satisfied the procedural requirements provided for in sections 164(5) to (8) and sent a demand to the company has no further rights in respect of those shares other than to be paid their fair value.⁷⁰ This is based on the premise that the dissident has voluntarily elected to 'opt out' of the company and all that remains is for the dissident to be paid the fair value of those shares.⁷¹

The dissidents also lose their rights to future distributions and to vote with effect from that point on however, the ambit of the relinquished rights is not clear for example it is left open whether the dissidents would have the right to bring an oppression application which is a remedy to a shareholder or director of a company for the

⁶⁵ If the shareholder has failed to receive notice of the resolution.

⁶⁶ Section 164 (7) of Companies Act 71 of 2008.

⁶⁷ Section 164(8) of the Companies Act, although the twenty business days requirement in s 165 (7) of the Act, it clearly does not apply to delivery of the demand to the Panel. It is not clear why the requirement to deliver the demand to the Panel applies in respect of all companies, including companies that are not 'regulated companies'.

⁶⁸ The demand must state the shareholder's name and address, the number and class of shares in respect of which he seeks payment, and a demand for the payment of the fair value of those shares.

⁶⁹ Pike op cit note 22 at 27.

⁷⁰ Section 164 (9) of Companies Act 71 of 2008.

⁷¹ Cassim et al op cit note 7 at 802.

abuse of the separate juristic personality of the company as contemplated in section 163.

Section 184 (11) of the Canada Business Corporations Act⁷² was similarly worded to Section 164 (9) of the South African Companies Act and thus may be helpful in the resolution of the ambit of the rights lost by the dissenting shareholder.⁷³

A Canadian court in the case of *Brant Investments Ltd v Keeprite Inc*⁷⁴ held that on submission of a demand, a dissident did not lose the right to challenge oppressive action but only lost the rights to dividends of the company and to vote because the appraisal remedy was a contingent remedy which entitled the dissident to withdraw his demand; and retain his full rights as a shareholder. Under South African legislation, a similar approach is adopted.⁷⁵

Although a shareholder relinquished all their rights in respect of his/her shares, the shareholders rights are reinstated without interruption in three circumstances: first, in the event that the dissenter withdraws the demand before the company makes an offer, or allows the offer made by the company to lapse; secondly, where the company fails to make an offer and the shareholder withdraws the demand; thirdly, where the company revokes the adopted resolution by way of special resolution regarding the fundamental transaction in question, that gave rise to the shareholder's appraisal right.⁷⁶

Section 164 does not explicitly disallow partial dissent however, section 164(5) provides that a dissenting shareholder may demand the fair value for 'all of the shares of the company held by that person'; this suggests that partial dissent by the shareholder is not permissible and implies that a dissenting shareholder must demand that the company purchase all of his shares regardless of their class thus preventing shareholders from hedging their bets.⁷⁸

⁷² S.C. 1974-75-76, c. 33.

⁷³ ⁷⁴ Provides that 'After sending a notice...a dissenting shareholder ceases to have any rights as a shareholder except the right to be paid the fair value of his shares as determined under this section, unless the dissenting shareholder withdraws his notice before the corporation makes an offer...in which case his rights as a shareholder are reinstated.'

⁷⁴ (1983) 44 OR (2d) 661 (Ont HC) at 664.

⁷⁵ Section 164(9)(a) to (c) and s 164(10).

⁷⁶ Section 164 (9) and (10).

⁷⁸ Cassim et al op cit note 7 at 803.

Section 164(5)(a)(ii) provides that for a dissenting shareholder to exercise the appraisal remedy, where there has been an amendment to the company's memorandum of incorporation, the dissenter must hold '*shares of a class that are materially adversely affected by the amendment*'.

The wording of Section 164 (5) is ambiguous because the two operative phrases, namely '*all of the shares*' and '*shares of a class*' are seemingly at odds with each other and it appears that if an amendment affects only a particular class of shares, the dissident may only exercise the appraisal remedy in relation to *all the shares* held by it.⁷⁹

Relinquishing all the shares held by a dissident would be unjust and prejudicial; this is not what the legislature intended ; whereas from a company's perspective, proposing *bona fide* amendments to the Memorandum of Incorporation that affect one class of shares could be a way to prevent opportunistic dissidents from liquidating their capital; thus affecting the liquidity of the company. A narrow interpretation of section 164(5) would result in an unfairness and prejudice to the dissident thus it is submitted that the dissidents demand must only relate to shares that fall within the affected class.⁸⁰ It is also submitted that the reading of s164 (8) (b)⁸¹ implies that the legislature intended to permit partial dissent.

Section 190 (1) of the Canadian Act⁸² allows for partial dissent because it states that a holder of shares, of any class, of a company may dissent if the company resolves to pass a resolution undertaking the following: amend its articles to add, change or remove any provisions restricting or constraining the issue and transfer ownership of shares of that class. Section 190(3) entitles a shareholder who dissents to be paid by the company the fair value of the shares in respect of which the shareholder dissents. This further implies that under the Canadian law, partial dissent is permitted. Section 190 (4) qualifies the right to partial dissent by stating that a dissenting shareholder may only claim in respect of all the shares of a class, held on behalf of any one beneficial owner and registered in the name of the dissenting shareholder. It must be stated that the Canadian position is that a dissenting

⁷⁹ Pike op cit note 22 at 27.

⁸⁰ Cassim et al op cit note 7 at 803.

⁸¹ The demand must state the number and class of shares in respect of which the shareholder seeks payment

⁸² Canada Business Corporations Act, 1985.

shareholder may dissent in relation to one class of shares, even if it holds shares in more than one class, provided that it dissents in relation to all the shares in that class, held by it.⁸³

(e) Offer by the company

Once the company has received a written demand from dissenting shareholders to be paid the fair value of their shares, the company must, within five business days, after the later of:⁸⁴ (a) on which the action approved by the resolution is effective; (b) the last day of receipt of demands in terms of subsection (7) (a) or; (c) or the day the company received a demand as contemplated in subsection (7) (b) if applicable, send to each shareholder who has sent such a demand a written offer to pay an amount considered by the company's directors to be the fair value of the relevant shares; accompanied by a statement showing how the value was determined.

The fair value must be determined as at the date on which, and at the time immediately before, the company adopted the resolution that gave rise to the shareholders appraisal rights.⁸⁵ Every offer made by the company to the dissenting shareholders, in respect of shares of the same class or series, must be on the same terms. In addition, the offer lapses if it has not been accepted within thirty business days after it was made.⁸⁶

The Companies Act does not specify how the fair value of the shares is to be arrived at but it must be noted that fair value does not necessarily mean market value, as in most cases the market value is usually not the true value of a company.⁸⁷ It is submitted that South African courts can seek guidance from and emulate the long-standing judicial experience of the Delaware courts which have for some time undertaken court valuations and developed its jurisprudence in this regard.⁸⁸

Section 164, does not impose a penalty in circumstances where a company fails to make an offer at all but a dissident shareholder may have to resort to invoking

⁸³ Pike op cit note 22 at 21-22.

⁸⁴ Section 164 (11) (a), (b) and (c).

⁸⁵ Section 164 (16).

⁸⁶ Section 164 (12) (a) and (b).

⁸⁷ Cassim et al op cit note 7 at 809.

⁸⁸ Ibid.

Section 218 (2).⁸⁹ This provision is important for two reasons; (a) it gives any person *locus standi* whether or not they have shareholder rights; and it imposes strict liability.⁹⁰

(f) Shareholder's acceptance of the offer

A dissenting shareholder who has made a written demand to the company to be paid the fair value of the shares has an option whether to accept or reject the offer made by the company for the shares, within thirty business days after which the offer was made otherwise the offer lapses.⁹¹ If the offer lapses, all the shareholders rights in respect of those shares, are reinstated without interruption.⁹²

If a dissenting shareholder accepts the offer, the dissident must tender the share certificates to the company or its transfer agent and in the case of uncertified shares, the dissident must take the steps required by Section 53 to direct the transfer of the shares to the company or its transfer agent.⁹³

Once the company has received notice of acceptance of the offer made to the dissenting shareholder and the dissenter has surrendered the share certificates or directed the transfer of the uncertified shares to the company, the company must within ten business days, pay that dissenter the agreed amount.⁹⁴ If however, the company has reasonable grounds to believe that in settling the agreed upon amount for the shares to the dissenter, the company will be unable to pay its debts, the company may apply to a court for an order varying its obligations.⁹⁵

The question that arises is whether the company either pays a dissenting shareholder the agreed amount, or applies to the court for an order varying its obligations? The dissenting shareholder also has a right to apply to court to determine the fair value of the shares, where the company has made an offer which

⁸⁹ Any person who contravenes any provision of this Act is liable to any other person for any loss or damage suffered by that person as a result of that contravention.

⁹⁰ Section 218(2) does not provide for a fault standard.

⁹¹ Section 164 (12) (b).

⁹² Section 164(9) and (10).

⁹³ By a dissident sending an instruction to transfer which is properly authenticated and effecting transfer in accordance with the rules of a central securities depository through the debiting of the dissidents account in the uncertified securities register and crediting the company's account in the uncertified securities register.

⁹⁴ Section 164 (13) (b).

⁹⁵ Section 164 (17) (a).

the shareholder considers to be inadequate or if no order was made at all.⁹⁶

However, section 164 does not make provision for a dissenting shareholder to apply to court if the company simply fails to pay the agreed amount.

It is submitted that where a company fails to pay, the dissenter will have to prove that there existed a valid contract between the dissenter and the company that the company made an offer and the dissenter accepted the offer by tendering his shares for the agreed amount, which renders the shareholder a creditor of the company.⁹⁷

The dissident may also rely on section 218(2)⁹⁸ to find the company liable for the loss or damages the dissenter has suffered.

(g) Application to court to determine fair value

In the event that the company neither makes an offer at all or makes an offer that is considered by the dissident to be inadequate, after the dissident has submitted a written demand, the dissident may apply to a court for judicial appraisal to determine the 'fair value' of the shares, together with an order requiring the company to pay the dissident the fair value as determined by the court; provided the offer has not lapsed (if it has not been accepted within 30 business days).⁹⁹

When the appraisal right is invoked, the involvement of the court is not inevitable or automatic but only occurs at the final stages of the appraisal procedure, if and when necessary.¹⁰⁰ Minimal court involvement is one of the most appealing features of the appraisal right and a means to promote settlement, thus before the court gets involved in the determination of the fair value of the shares, the dissenters have a right to accept the offer made by the company in respect of the fair value of the shares.¹⁰¹ This, however, may also be susceptible to abuse by shareholders.¹⁰²

⁹⁶ HGJ Beukes 'An Introduction to the Appraisal Remedy in the Companies Act 2008: Standing and the Appraisal Procedure' (2010) 22 *SA Merc LJ* 176 at 190.

⁹⁷ *Ibid.*

⁹⁸ Which makes any person who contravenes this section liable to any other person for any loss or damage suffered by that person as a result of that contravention.

⁹⁹ Section 164(14).

¹⁰⁰ Cassim et al op cit note 7 at 805.

¹⁰¹ Section 164(15)(a).

¹⁰² Cassim et al op cit note 7 at 806.

On an application to the court for judicial appraisal of the shares, all dissenting shareholders who have not accepted an offer from the company as at the date of the application, must be joined as parties and are bound by the decision of the court.¹⁰³ It must be noted that the fair value as determined by the court, will not apply to dissenting shareholders who had initially accepted the offer made by the company of the fair value of the shares.¹⁰⁴ The company must notify each affected dissenting shareholder of the date, place and consequences of the application and of their right to participate in the court proceedings.¹⁰⁵ Furthermore, the court may determine whether any other person is a dissenting shareholder who should be joined as a party.¹⁰⁶

The Act¹⁰⁷ is not clear as to who falls into the category of being an affected dissenting shareholder but a deduction could be made that, it is any dissenting shareholders who has not accepted the offer made by the company as at the date of the application.¹⁰⁸ Section 190(19)(a) of The Canadian Act¹⁰⁹ on the other hand, is clearly defines, who would be considered an affected dissenting shareholder by stating that: dissidents who are party to the application are 'all dissidents', whose shares have not been purchased by the company.

The court must determine the 'fair value', in respect of the shares of all the dissenting shareholders, as at the date on which, and time immediately before, the company adopted the resolution that gave rise to the shareholder's appraisal rights.¹¹⁰ The Act is silent on the meaning of 'fair value' and does not provide a method of valuation.¹¹¹ The court is however, given the discretion to appoint one or more appraisers to assist it in determining the fair value.¹¹² It must be noted that in most cases the 'fair value' is not necessarily equivalent to the market value alone

¹⁰³ Section 164 (15)(a).

¹⁰⁴ Cassim et al op cit note 7 at 805.

¹⁰⁵ Section 164 (15) (b).

¹⁰⁶ Section 164 (15) (c) (i).

¹⁰⁷ Companies Act 71, 2008.

¹⁰⁸ Section 164(15)(a).

¹⁰⁹ Canadian Business Corporations Act, 1985.

¹¹⁰ Section 164(15)(c)(ii); s 164(16).

¹¹¹ Cassim et al op cit note 7 at 805.

¹¹² Section 164(15)(c)(iii)(aa).

and may not be a true reflection of the worth of the company; for instances in cases where the shares are undervalued or there is no market for the shares.¹¹³

Even though the fair price of shares has been considered in the context of the oppression remedy under section 252¹¹⁴ and the mandatory acquisition of shares of minorities¹¹⁵, the scenarios in which these provisions apply, are totally different in that they do not involve a willing buyer and seller transaction, unlike with the appraisal remedy.¹¹⁶

This problem is further compounded by the fact that South African courts do not appear to have accessed the well-developed international jurisprudence relating to the valuation of shareholding. The case of *Hickman v Oban Infrastructure (Pty) Limited*¹¹⁷ presented an opportunity for the courts to determine critically and consolidate the definition and interpretation of the valuation of shares but this opportunity was, unfortunately, missed.¹¹⁸

The Act does not specifying the method for evaluation of the fair value, which creates confusion and uncertainty because it does not stipulate a standard method on how to determine the fair value; especially because the fair value is not necessarily equivalent to market value. In many instances market value is not a true reflection of the worth of the company or the fair value of its shares; for instance where the shares are undervalued on the market or in a depressed market or where there is no market for the shares.¹¹⁹

Foreign jurisdictions, in particular the US state of Delaware, have developed a sound valuation methodology over a period of 150 years. Taking into account the

¹¹³ Cassim et al op cit note 7 at 809.

¹¹⁴ The Companies Act, 1973.

¹¹⁵ Section 440k of the Companies Act, 1973.

¹¹⁶ Cassim et al op cit note 7 at 809.

¹¹⁷ (unreported case no. 2008/18332, judgement delivered on March 3 2010).

¹¹⁸ The brief facts of the case were that the applicant was excluded from the management of the company due to a deterioration in the relationship between the applicant and another shareholder who had considerable influence over the other shareholders. As a minority shareholder, the applicant sought either to have his shares bought in terms of the broad remedies that a court could grant under s252(3) of the old Companies Act (81 of 1973) or, in the alternative, to have the company wound-up in terms of s344(h) of that Act on the grounds of loss of confidence in the management of the company and his exclusion from the company's subsidiary. The court found in favour of the applicant and ordered that the applicant's shares must be purchased at a fair market value, but it failed to stipulate how the fair market value was to be determined. It merely ordered that a valuer be appointed to determine the 'fair market value' of the shares and that the valuer's finding would be binding on the parties.

¹¹⁹ Cassim op cit note 13 at 167-171.

developments in foreign jurisdictions, it is suggested that the legislature should consider amending or extending the current Act or Regulations to give guidance to the courts on how to assess fair value of the minority's shareholding. This will provide the courts and the applicants clarity regarding the application of the appraisal remedy.¹²⁰

In addition to determining the 'fair value' of the shares, the court must also make an order: requiring the dissenting shareholders to either withdraw their respective demands or take the necessary steps to surrender or transfer their shares to the company. Further, the court should require the company to pay the fair value of the shares to each dissenting shareholder who takes the necessary steps to surrender or transfer the shares to the company, subject to any conditions the court considers necessary to ensure that the company fulfils its obligations under section 164.¹²¹

It can be conceded that section 164(15)(c)(v) was poorly drafted because it is unclear what 'all of the shareholder's rights in respect of the shares are *reinstated* without interruption' means.¹²² If a withdrawal of the demand is ordered or chosen, it is assumed that the dissident's rights in respect of the shares are reinstated without interruption. The reinstatement of rights only occurs if any of the three circumstances in section 164(9) arise: first, reinstatement is possible if the demand is withdrawn before the offer is made.¹²³ This cannot be possible in the circumstances because the offer would have already been made. In order to approach the court, the offer must have already been made and not lapsed.¹²⁴ Secondly, reinstatement is possible if the company did not make an offer.¹²⁵ Similarly, this too would also not be possible. Thirdly, reinstatement is possible if the resolution is revoked.¹²⁶ Again, this will not be the case because approaching the courts implies that the resolution still stands and a fair value is being sought.

Further, it is not clear whether the dissenting shareholder has a choice to withdraw its demand or tender his/her shares and accept the judicially determined fair value or, whether it is at the court's discretion to make an order instructing each dissenting

¹²⁰ Cassim et al op cit note 7 at 809.

¹²¹ Section 164 (15)(c)(v).

¹²² Section 164(10).

¹²³ Section 164(9) (a).

¹²⁴ Section 164(14).

¹²⁵ Section 164(9)(b).

¹²⁶ Section 164(9)(c).

shareholder to withdraw its demand; or alternatively order his/her shares to be tendered to the company in exchange for the fair value.¹²⁷ While the former interpretation may seem more literal, the latter view is more logical and reasonable.¹²⁸

If this section is read to allow each dissenting shareholder a choice to either withdraw his/her demand and be reinstated to his/her full rights or tender his/her shares and receive the judicially determined value; it would encourage shareholders to dissent from transactions and exercise appraisal rights on a 'no-lose' basis. Dissenting shareholders would, thus, be able to withdraw their demand if the judicially determined fair value turns out to be less than the fair value that was offered by the company but ultimately receive the judicially determined value.¹²⁹

It is submitted that the Delaware model should be followed: a dissenting shareholder, who does not withdraw his/her request for appraisal and accepts the offered price, *will* receive the judicially determined 'fair value'.¹³⁰ It is also worth noting that the Canadian Act does not make provision for the lapse of an offer and for the reinstatement of the dissidents rights.

Since the court has a discretion to make an order of costs, having regard to any offer made by the company and the final determination of the fair value¹³¹, the order of costs against a dissenting shareholder could serve as a deterrent to judicial appraisal.¹³² It is hoped that when the court makes an order of costs, the court will take into account the uncertainty created by the valuation of shares to shareholders; as this may often yield unpredictable results, since valuation is not an exact science but merely a prediction or an estimate.¹³³

Section 164 (15A) gives dissenting shareholders a choice, at any time before the court makes a determination of fair value, to accept the company's offer of fair value. This is intended to promote settlement; however, it is also susceptible to abuse by

¹²⁷ Davids *op cit* note 30 at 361.

¹²⁸ *Ibid.*

¹²⁹ *Ibid* at 362.

¹³⁰ *Ibid.*

¹³¹ Section 164 (15) (c)(iv).

¹³² Cassim *et al op cit* note 7 at 806.

¹³³ *Ibid.*

shareholders.¹³⁴ Section 164 (15) (c) (iii) (bb) gives the court discretion to permit a reasonable rate of interest on the amount payable to the dissenting shareholders, from the date that the action was approved by the resolution, is effective until the date of payment. The rationale behind this is to compensate the dissenting shareholder for the loss of the use of his funds during this period.¹³⁵

(h) Court application by company to vary obligations

Section 164(17) provides that if there are reasonable grounds to believe that compliance by a company with subsection (13) (b), or with a court order in terms of subsection (15) (c) (v) (bb), would result in the company being unable to pay its debts as they fall due and payable for the ensuing 12 months, the company may apply to a court for an order varying the company's obligations. The court also has the discretion and may make an order that: is just and equitable, having regard to the financial circumstances of the company, the interests of the minority shareholder; and to ensure that the dissenter is paid at the earliest possible date, in relation to the company satisfying its other financial obligations when they fall due and payable.¹³⁶ A successful application by the company can have the effect that the amount payable by the company and/or the date of payment is varied.¹³⁷

Whether the court varies the company's obligations or whether it has to objectively determine the fair value of the shares under judicial determination; Beukes submits that the agreed amount should be taken into consideration because the acceptance of the offer by the dissident a valid contract which exists between the dissident and the company which implies that the parties agree that the offer reflects the fair value of the shares.¹³⁸ Beukes position is based on the rationale that when the company brings an application for an order varying its obligations in terms of Section 164 (17),

¹³⁴ Cassim et al op cit note 7 at 806.

¹³⁵ Ibid.

¹³⁶ Section 164 (17) (b) (i) and (ii).

¹³⁷ Beukes op cit note 96 at 192. Although there is no specific provision in s 164 to this effect, it can be argued that both the agreed amount and the date of payment constitute terms of the company's obligations towards a dissenting shareholder and, therefore, that a variation of the company's obligations can include a variation of either or both of these terms.

¹³⁸ Ibid.

'the court is merely asked to vary the company's existing obligations in a just and equitable way having regard to its financial circumstances'.¹³⁹

In contrast to the Canadian Act¹⁴⁰, which permits the approval of the implementation of a short-form merger by way of a board resolution of each merging company, the South African Companies Act¹⁴¹ does not have any such provision.

¹³⁹ *Ibid.*

¹⁴⁰ See section 184 of the Canada Business Corporations Act, 1985.

¹⁴¹ A short form merger is a simplified form of a merger between a holding company and its wholly-owned subsidiary, called a vertical short-form merger, or between two wholly-owned subsidiaries of a holding company, known as a horizontal short-form merger, cf Cassim *op cit* note 7 at 155 & 158.

V THE EFFECTIVENESS OF THE APPRAISAL REMEDY AS A FORM OF MINORITY SHAREHOLDER PROTECTION

Section 164's perfection procedure is critical in determining the effectiveness of the appraisal remedy as a form of minority shareholder protection in fundamental transactions. A remedy that is efficient, less time consuming would be attractive to dissenting shareholders and this would encourage dissidents to seek a fair value of their shares.¹⁴²

It is submitted that the appraisal procedure under the Act¹⁴³, has severe procedural limitations which tend to curtail its effectiveness as a shareholder protection remedy.¹⁴⁴ The appraisal remedy procedure is complex and rigid and the procedural requirements that have to be fulfilled before the perfection of the appraisal remedy, are cumbersome. Thus this makes it difficult for shareholders to invoke the appraisal remedy without legal assistance and they are likely to incur legal costs, without the guarantee that the appraisal remedy will be available to the shareholder, as the requirements may not have been fulfilled.¹⁴⁵

'The perfection procedure should be viewed as a balancing mechanism (a scale) that attempts to balance the liberalisation of fundamental transaction policy, which favours the facilitation of efficient business combinations through majority shareholder control, against the appraisal remedy's principal purpose of protecting minority shareholders from being 'cashed-out' of their investment on unfair terms set by the majority'.¹⁴⁶ The 'cashing out' of minority shareholders may have the effect of draining the company's financial resources; thus the fundamental transaction may not be economically viable.¹⁴⁷ The appraisal rights legislation was not originally drafted with the objective to create 'cash-out' transactions, existing legislation does not fully achieve this purpose.¹⁴⁸ It is submitted that currently, the perfection

¹⁴² Manning op cit note 24 at 230.

¹⁴³ Companies Act No 71 of 2008

¹⁴⁴ Cassim op cit note 13 at 164.

¹⁴⁵ Ibid.

¹⁴⁶ Nicol op cit note 8 at 34.

¹⁴⁷ Ibid.

¹⁴⁸ B M Wertheimer 'The Shareholders' Appraisal Remedy and How Courts Determine Fair Value' (1998) 47 *Duke Law Journal* 613 at 702.

procedure does not achieve an appropriate balance between the interests of the company and the interests of the minority shareholders, which was the rationale behind the appraisal remedy; to protect the interests of the minority shareholder while taking into consideration the interests of the company.¹⁴⁹

It is worth noting that the appraisal procedure is skewed in favour of the company in that the latter suffers no similar adverse consequences for non-compliance with its complementary procedural obligations.¹⁵⁰ If the dissenting shareholder fails to deliver to the company both a written notice of objection and a written demand of payment within the time frames stipulated in the Act, he/she loses his appraisal remedy.¹⁵¹ On the other hand, however, the company suffers no real adverse consequences by its failure to make a written offer to pay the fair value of the shares. Nor does it suffer any adverse consequences for failing to send a notice of the shareholders meeting where the proposed resolution will be considered, without the requisite statement of the appraisal remedy and the notice of the adoption of the resolution.¹⁵²

The dissenting shareholder is also given a strict period of 30 days after the written offer (if any) has been made by the company, within which to apply to court for judicial appraisal of the shares.¹⁵³

Once a shareholder demands payment for the fair value of the shares in terms of section 164 (5), he loses all further rights in respect of those shares, other than to be paid their fair value.¹⁵⁴ Should the shareholder opt for judicial appraisal, the dissenter is not entitled to receive any form of payment from the company up until the court has judicially determined the fair value of the shares.¹⁵⁵

This has an adverse effect on the dissenter in that the court may determine the fair value of the shares years after the fundamental transaction occurred; this also

¹⁴⁹ Nicol *op cit* note 8 at 34.

¹⁵⁰ Cassim *et al op cit* note 7 at 807.

¹⁵¹ *Ibid.*

¹⁵² In the event of the company's failure to comply with the former requirement, the only consequence is that the shareholder is excused from sending a notice of objection to the company (section 164 (6)). Should the company fail to send the latter notice (*i.e* notice of adoption of the resolution), the only consequence is that the shareholder's prescribed 20 business day period (within which to deliver a written demand to the company) starts to run from the day that the shareholder learns of the adoption of the resolution (section 164 (7) (b)).

¹⁵³ Section 164 (12) (b) read with Section 164 (14) (b).

¹⁵⁴ Section 164(9).

¹⁵⁵ Section 164(15)(c)(v)(bb).

becomes an incentive to the company to delay the process for as long as possible with the hope that the dissenter might accept the offer that was initially made by the company.¹⁵⁶ Consequently, the shareholder may not afford to finance the appraisal litigation, thus becomes compelled to settle for the amount that was offered by the company reluctantly instead of pursuing judicial appraisal.¹⁵⁷

Although section 164(15)(c)(iii)(bb) gives the court the discretion to award dissenting shareholders who pursue judicial appraisal, a reasonable rate of interest on the fair value, from the date that the action is effective until the date of payment; an interest award may sufficiently compensate dissenting shareholders for the loss of the use of their funds. This however, does not assist their pursuit of judicial appraisal, as it is only awarded at the conclusion of the court proceedings.¹⁵⁸

It is submitted that the Model Business Corporation Act (MBCA)¹⁵⁹ should be followed in this regard as it allows a dissenter to receive payment of the amount the company deems to be the fair value of the shares very early in the process, whilst the court judicially appraises the fair value of the shares, if necessary. Section 13.24(b) (2) requires that estimate to be at least equal the company's estimate of fair value given pursuant to section 13.22(b) (2) (iii). Since all rights as a shareholder are terminated with the deposit of the shareholder's shares, as provided for in section 13.23(a), the former shareholder should have immediate use of the money and a difference of opinion over the total amount to be paid should not delay payment of the amount that is undisputed.¹⁶⁰

The rationale behind this is that it serves three purposes: a) the undisputed amount is paid out to the dissenter so that it may be used to fight the company whilst awaiting judicial appraisal of the fair value; b) the amount under dispute is reduced when the court judicially appraises the fair value of the shares; c) and if the company's estimate of fair value¹⁶¹ is more than the amount judicially determined by

¹⁵⁶ Cassim et al op cit note 7 at 808.

¹⁵⁷ M Siegel 'An Appraisal of the Model Business Corporation Act's Appraisal Rights Provisions' (2011) 74 *Law and Contemporary Problems* 231 at 236.

¹⁵⁸ Ibid at 806.

¹⁵⁹ The Model Business Corporation Act, 2008.

¹⁶⁰ Model Business Corporation Act Annotation § 13.24 official comment (1999).

¹⁶¹ Section 13.24 (b) (2) requires that the corporation's estimate of fair value be at least equivalent to the fair value number that the corporation listed on its section 13.22 form.

the court, the dissenter is under no legal obligation to repay the difference back to the company. The effect of this is that, when the company knows that the interim payment of fair value could be a loss to it, it will be compelled to be fair when estimating the fair value of the shares at the beginning of the process.¹⁶²

The costs involved in pursuing the appraisal remedy inhibits its appeal to dissenting shareholders because it is a technical procedure that requires experts and attorneys to advise the dissident, who is usually a layperson in legal matters. The court has a discretion to make an appropriate order of costs, having regard to any offer made by the company and the final determination of the fair value by the court.¹⁶³ Although the aim is to encourage the parties to negotiate in good faith and avoid the involvement of the court through judicial appraisal, the outcome is usually that the dissident may be left out of pocket. The fact that there is no guarantee that the court will judicially appraise the fair value of the shares in the dissidents favour, makes most dissidents reluctant to go to court and incur costs which might outweigh the benefits.¹⁶⁴

Section 13.31(a) of the MBCA¹⁶⁵ requires the court to determine the court costs of the proceeding, including the compensation and expenses of court-appointed appraisers against the company. It is assumed that in the absence of conduct that is arbitrary or vexatious by dissenting shareholders, the company absorbs the costs of the proceedings however, the court is authorised to assess these court costs, in whole or in part, against all or some of the shareholders that are seeking judicial appraisal and if it concludes that the dissenting shareholders acted arbitrarily or not in good faith.¹⁶⁶ The Delaware statute¹⁶⁷ also grants the court the discretion on how to allocate costs of the proceedings by stating that: "[t]he costs of the proceeding may be determined by the Court and taxed upon the parties as the Court deems equitable in the circumstances."¹⁶⁸

However, it must be noted that although both statutes are silent on whether a court may assign expert and attorney expenses to an adverse party; Delaware case law

¹⁶² Siegel op cit note 155 at 236.

¹⁶³ Cassim et al op cit note 7 at 808. See section 164(15)(c)(iv)

¹⁶⁴ Ibid.

¹⁶⁵ Model Business Corporation Act, 2008.

¹⁶⁶ Model Business Corporation Act Annotation § 13.31 (a) official comment (1999).

¹⁶⁷ DEL. CODE ANN. tit. 8, § 262(j) (2001).

¹⁶⁸ Ibid.

recognises bad faith as an equitable exception to the rule that parties bear their own costs for experts and attorneys.¹⁶⁹ It is submitted that under South African legislation, judicial appraisal costs could be divided in a similar way as under the MBCA or Delaware statute and the statutory presumption of costs would give dissenting shareholders more concrete assurance as to the allocation of costs; than through the discretionary court allocation of the costs.¹⁷⁰

Under the MBCA, the court also has a discretion to make an order of costs which it deems equitable against the company and is in favour of any or all of the shareholders, if the company failed to substantially comply with the requirements of s13.20 (notification to shareholders of the proposed transaction and the appraisal rights available to them); s13.22 (the company providing shareholders with information and a form for perfecting appraisal rights); 13.24 (the company paying the dissenting shareholders the estimate amount in cash of the fair value for the shares plus interest within 30 days) or s13.25 (failure to pay the shareholder in cash, the stated fair value plus interest within 10 days after receiving a shareholders acceptance).¹⁷¹ The court may also make an order of costs against the company or a shareholder demanding appraisal, if the court finds that the party against whom the expenses are assessed acted arbitrarily, vexatiously, or in bad faith.¹⁷²

In an appraisal proceeding, if the court finds that the expenses incurred by any dissenting shareholder were of substantial benefit to other shareholders and that such expenses should not be assessed against the company. The court may issue an order directing that such expenses be paid out of the amounts awarded to the shareholders who benefitted.¹⁷³ If the company also fails to make the required payment pursuant to ss 13.24, 13.25 or 13.26, the shareholder may sue directly for the amount owed and shall be entitled to recover from the company all expenses of the suit.¹⁷⁴

In contrast, in South Africa the company does not incur any adverse consequences for failure to make an offer to the dissident; but the position is different in the US in

¹⁶⁹ Siegel op cit note 155 at 241.

¹⁷⁰ Ibid at 242.

¹⁷¹ Section 13.31 (b).

¹⁷² Section 13.31 (b) (2).

¹⁷³ Section 13.31(c).

¹⁷⁴ Section 13.31(c).

that the company must, within 60 days after a demand for payment of the fair value by the dissenter has been received, effect such payment plus interest.¹⁷⁵ Failure by the company to commence proceedings for judicial appraisal within this period, results in the company being liable to pay the additional amounts demanded by dissenters under section 13.26.¹⁷⁶ 'The purpose of all these grants of discretion with respect to expenses is to increase the incentives of both sides to proceed in good faith under this chapter, to attempt to resolve their disagreement without the need of a formal judicial appraisal of the value of shares'.¹⁷⁷

Another area that needs improvement in South African Company law is with respect to the stringent procedures that must be complied with in the perfection of the appraisal remedy, as the requirements remain onerous to the dissenting shareholder.¹⁷⁸ The shareholders are particularly at a disadvantage because the company will usually already have access to funds for legal representation and proper guidance to comply with the complex procedural requirements.¹⁷⁹ Although these statutory procedures are intended to notifying the company at an early stage as to the number of dissenting shareholders for planning purposes and provide a timeframe for the appraisal process to be completed to prevent unnecessary delays; penalising shareholders who deviate insignificantly from the mandatory procedures defeats the purpose of the appraisal remedy. The MBCA has reduced, but not eliminated, the procedural burdens placed on the dissenting shareholders.

There is reasonable consensus amongst commentators that strict adherence to the perfection procedure has deterred dissenters from exercising the appraisal remedy, even when there has been no prejudice to the company.¹⁸⁰ It is submitted that adopting a statutory 'harmless error rule' or 'substantial compliance defence'; whereby minor defects in compliance with procedural requirements of a statute would not be fatal to the shareholders appraisal remedy.

On condition that the company received the dissenter's notice of intention to dissent before the transaction was voted on and there is no substantial prejudice that the

¹⁷⁵ Section 13.30.

¹⁷⁶ Model Business Corporation Act Annotation § 13.26 official comment (1999).

¹⁷⁷ Model Business Corporation Act Annotation § 13.31 (a) official comment (1999).

¹⁷⁸ See section 164(5)(c)(ii), which requires that a shareholder comply with all the procedural requirements of s 164 in order to be eligible to claim the fair value of his shares.

¹⁷⁹ Cassim et al op cit note 7 at 808.

¹⁸⁰ Wertheimer op cit note 146 at 708.

company incurs. This would make the appraisal remedy more effective.¹⁸¹ It is hoped that the court will interpret the dissenting shareholders procedural obligations with leniency and flexibility so as to excuse shareholders who make genuine attempts but still fail to comply strictly with the prescribed procedure and time periods.¹⁸²

It is worthy to note that the judicial determination of the fair value of shares does not follow a set procedure but rather is merely a prediction or estimate. This creates uncertainty and a substantial risk that the shareholder's estimate of the fair value of the shares may be higher than the valuation made by the court.¹⁸³ The wording in the Act¹⁸⁴ states that the court must determine 'a' fair value and not 'the' fair value; this suggests/implies that that the fair value could be a *range of values* and not a particular figure. In as much as the court has discretion to allocate costs¹⁸⁵, the uncertainty as to the valuation of the shares may discourage dissenting shareholders from pursuing judicial appraisal. It is submitted that the Act should explicitly state that the order of costs will be for the company's account and the court must be given further discretion to allocate expert and statutory costs where either party acts in bad faith during the negotiations.¹⁸⁶ This will be a deterrent and will encourage the parties to negotiate in good faith.

The statutory presumption has the effect of making judicial appraisal more economically feasible for the dissenting shareholder as opposed to the present discretionary nature of the allocation of costs under the Act; which would make judicial appraisal more attractive to dissenting shareholders.¹⁸⁷ 'Supporters of judicial appraisal have argued that if absent some substantial financial relief, appraisal rights are merely a theoretical right for those who own only a small number of shares'.¹⁸⁸

In conclusion, it must be stated that the South African legislature drafted a cumbersome procedure that requires perfection of its requirements for it to be

¹⁸¹ Wertheimer op cit note 146 at 708. It is worth noting that the notion of substantial compliance has been introduced into the new Companies Act under s 6(8)(a) & (b). According to this provision if a form of a document, record, statement or notice is prescribed by the Act it is sufficient that the document, record, statement or notice satisfies the 'substantive requirements of the prescribed form'.

¹⁸² Cassim et al op cit note 7 at 808.

¹⁸³ Ibid.

¹⁸⁴ Section 164 (15) (c) (ii)

¹⁸⁵ Section 164(15)(c)(iv)

¹⁸⁶ Nicol op cit note 8 at 39.

¹⁸⁷ Siegel op cit note 155 at 242-43.

¹⁸⁸ Ibid at 243.

effective; thus the scales are tipped in favour of the majority shareholders as the perfection procedure is complex, technical, time consuming and costly for minority shareholders to pursue. It essentially fails to strike a balance between the interests of the majority and the interests of the minority shareholders, which further detracts from the shareholder protection rationale underlying the appraisal remedy. The above stated recommendations can assist in striking a balance between the interests of the majority and minority shareholders through the simplification of the perfection procedure and requirements. Further, the simplification of the process for the appraisal remedy will facilitate of efficient business combinations through majority rule on the one hand and protecting minority shareholders on the other.

OTHER FORMS OF PROTECTION AVAILABLE TO MINORITY SHAREHOLDERS IN SOUTH AFRICA

It must be noted that the appraisal remedy forms part of a broader approval process and if viewed in its entirety, the appraisal remedy is the last but one step in the implementation process of certain transactions.¹⁸⁹

Section 115 states that despite the amendment of the company's Memorandum of Incorporation or any resolution adopted by the board, a company may not dispose of all or greater of its assets or undertaking, implement an amalgamation or a merger, or enter into a scheme of arrangement unless the proposed transaction is approved by a special resolution supported by at least 75 per cent of the persons entitled to exercise voting rights.¹⁹⁰ Furthermore, section 115(4) provides that any voting rights controlled by an acquiring party, a person related to an acquiring party or a person acting in concert with either of them must not be included in calculating the percentage of voting rights in support of the resolution.¹⁹¹

For the proposed transaction to be binding on the shareholders, the meeting called for that purpose must be attended by at least 25% of all persons entitled to exercise voting rights, a higher percentage may be required as per the company's Memorandum of Incorporation.¹⁹² It is worth noting that the voting rights controlled by an acquiring party, a person related to an acquiring party or a person acting in concert with either of them, must not be included in calculating the percentage of voting rights required to be present in determining whether the applicable quorum requirements have been met.¹⁹³

Even after the resolution has been approved, the company may not proceed to implement that resolution without court approval, if the resolution was opposed by at least 15% of the voting rights. Further, the company may not implement the resolution within 5 business days after approval of the resolution as any person who

¹⁸⁹ Pike op cit note 22 at 11.

¹⁹⁰ Section 115(1) read with section 115(2)(a).

¹⁹¹ See section 2(1) definition of 'related' to determine who is 'related' to an acquiring party.

¹⁹² Section 115(2)(a).

¹⁹³ Section 115(4)(a).

voted against it, may require the company to seek court approval.¹⁹⁴ In addition, a shareholder who voted against the resolution may make an application to court for leave to review the transaction within 10 business days after the resolution was approved.¹⁹⁵

Additional protection mechanisms apply, specifically, to schemes of arrangements¹⁹⁶ whereby the company must retain a qualified independent expert to compile a report to the board; the report must also be distributed to the shareholders so that they are fully aware of the details of the scheme and its effects on their shares, prior to voting on the resolution.

Furthermore, the 'majority of the minority' approval requirement protects minority shareholders in circumstances where the transaction is not conducted on an arms-length basis and where the acquirer is able to exert influence on the disposer.¹⁹⁷

In practice, the question is, how effective is the remedy afforded to a shareholder to approach a court for judicial review of a transaction? Firstly, the general grounds on which a court may review and set aside a resolution are limited to the transaction, not merely being unfair but manifest unfairness and procedural irregularity which must materially taint the transaction.¹⁹⁸ A second limitation to the protection mechanisms that have been discussed are the cost implications that shareholders have to incur to institute court proceedings; this may act as a deterrent.¹⁹⁹ It must be noted that the review remedy is only available to shareholders who voted against the resolution and not those who were not opposed to it; regardless of whether they suffer material loss or harm as a result of the transaction.²⁰⁰

¹⁹⁴ Section 115(3)(a).

¹⁹⁵ Section 115(3)(b).

¹⁹⁶ Section 114.

¹⁹⁷ Davids op cit note 30 at 357 and 358. States that this serves as a valuable protection for minority shareholders and is found under the 'Related Party' provisions of the JSE Listing Requirements (Rule 10.4(e)) and also under the 'whitewash' provisions of a mandatory offer under the previous Security Regulations Code (Rule 8.7).

¹⁹⁸ Ibid at 359.

¹⁹⁹ Ibid.

²⁰⁰ Ibid at 360.

VI MINORITY SHAREHOLDER PROTECTION IN THE UNITED KINGDOM

In its most basic form minority shareholder protection refers to principles or measures that protect minority shareholders' rights against the abuse of power by majority shareholders. Especially with companies that are small or medium-sized entities, owned by a small number of shareholders who in most cases also run the businesses as directors. Typically businesses start out as being controlled by family or friends through consensus and with little compliance with the formalities imposed by company law legislation. If the relationship upon which the business was run, breaks down and the shareholder with majority shareholding decides to operate the business as his own or to vote the minority shareholders out as directors, what recourse would the minority shareholders have in these instances?²⁰¹

The general principle is that a company is managed by its directors and not its shareholders thus a decision made by a majority of shareholders in a general meeting is binding on the minority.²⁰² In order to address the imbalance of power between the majority and minority shareholders and to secure the protection of minority shareholders, there are a number of protection mechanisms afforded to minority shareholders, contained mainly in the Companies Act.²⁰³

A brief overview of minority shareholder protection in the United Kingdom and the remedies available to minority shareholders will be discussed below.

(a) Unfair Prejudice

Section 994 of the United Kingdom Companies Act of 2006 (formerly section 459 of the Companies Act 1985) is the most important protection device afforded to minority shareholders in the UK; it gives minority shareholders the right to petition a court for an order protecting the shareholder(s) from unfair prejudice. The right to petition the court is founded on the allegation that the affairs of the company are being conducted by the majority in a manner that is prejudicial to the interests of the

²⁰¹ J Sykes *Minority Shareholders and their rights* (2009) 1 available at www.charlesrussel.co.uk accessed on 27 August 2014 at 1.

²⁰² *Ibid.*

²⁰³ UK Companies Act, 2006.

members generally, or to some part of its members²⁰⁴; or that an actual or proposed act or omission of the company (including an act or omission on its behalf) is or would be prejudicial to the minority shareholder (s).²⁰⁵ This includes a breach of a legal bargain between the shareholders, for example a Shareholders Agreement or Articles of Association; breach of fiduciary duty; breach of an equitable agreement or understanding; or breach of quasi-partnership principles.²⁰⁶²

The remedy that is most often sought under a Section 994 Petition is that the other shareholders buy their shares for a fair value: however, it is important to note that the Court has complete discretion as to who should purchase the shares and if the circumstances warrant, the court can even order the minority shareholder to purchase the shares of the majority.²⁰⁷

The court also has the discretion to make orders to adjust the unfair prejudice that the minority shareholder has suffered. For example, the court may order the company to be valued on the basis of the benefits taken by director/shareholders in breach of fiduciary duty, to be repaid.²⁰⁸ The court will also decide at what date the company should be valued and whether there should be any discount to reflect the minority shareholding.²⁰⁹ The court can also make an order regulating the conduct of the company's affairs in the future; require the company to do or refrain from any act and authorise civil proceedings to be brought in the name of the company.²¹⁰

(b) Derivative Claims

'In many circumstances, a minority shareholder may be affected by a wrong done, not to him personally but to the company by the majority. For example, diversion of contracts from the company to the directors personally. The minority shareholder faces an impossible task in attempting to force directors into bringing an action against themselves. In certain circumstances, however, the Courts will allow a

²⁰⁴ Section 994(1)(a).

²⁰⁵ Section 994(1)(b).

²⁰⁶ Sykes op cit note 199 at 1.

²⁰⁴ Sykes op cit note 199 at 1.

²⁰⁷ Law Commission Shareholder Remedies Report 246 Cm 3769 HMSO London (1997) para 6.15.

²⁰⁸ Sykes op cit note 197 at 1.

²⁰⁹ Ibid.

²¹⁰ Section 996(2).

minority shareholder to bring a claim in the company's name and the minority shareholder has no greater right to relief than the company would have were it to bring an action itself.²¹¹ Unlike the prejudice petition, any financial award granted accrues to the company itself.

Such “derivative claims” were formerly governed by the common law and were rarely brought to the courts. However, the Companies Act²¹² has given shareholders an important minority shareholder protection remedy, as it purports to shield shareholders from the effects of corporate personality and majority rule²¹³ through a statutory derivative claim under section 260. This section affords minority shareholders the right to bring a derivative claim; which replaces the common law exceptions to the rule, as decided in *Foss v Harbottle*²¹⁴ that shareholders previously had to rely on that the proper plaintiff to a wrong done to the company is the company itself. Section 260(3) provides that a derivative claim may be brought only in respect of a cause of action arising from an actual or a proposed act or omission involving negligence, default, breach of duty, or breach of trust by a director of the company. It is worth noting that a shareholder-director responsible for the negligent act will not be able to vote at a meeting of members called to ratify the act or omission.²¹⁵

It must also be noted that unlike the South African statutory derivative action under section 165²¹⁶; which is wider, extends its reach beyond instances of wrongdoer control of the company, is available to a wider class of applicants than just minority shareholders²¹⁷; the UK statutory derivative action under section 260 is limited in that the action can only be instituted by a shareholder of the company.

Derivative actions are expensive and time consuming for all the parties involved and a decision to bring a derivative claim is not one that should be taken lightly due to the amount of evidence that will be required, to support such a claim.

²¹¹ Sykes op cit note 199 at 2.

²¹² UK Companies Act, 2006.

²¹³ Cassim et al op cit note 7 at 776.

²¹⁴ 1843 2 Hare 461, 67 ER 189

²¹⁵ Section 239.

²¹⁶ SA Companies Act, 2008.

²¹⁷ Cassim et al op cit note 7 at 776.

(c) Personal Claims

All shareholders have rights that can be enforced against the company and other shareholders, whether or not a formal shareholder's agreement has been reached; and these include objections to the alteration of the Memorandum and Articles of Association, the variation of class rights, the giving of financial assistance and the enforcement of directors' duties, prevention of ultra vires transactions and in relation to certain take-over offers.²¹⁸

The Memorandum and Articles of Association represent a statutory agreement between the shareholders and the company as to how the company is to be run and the court will enforce a breach of that agreement.²¹⁹ An otherwise proper attempt to vary the articles can be actionable if it affects rights already in existence or if the majority has not acted in good faith.²²⁰

(d) Just and Equitable Winding-Up

As a last resort, the court has the power to wind up the company on 'just and equitable grounds'.²²¹ The burden of proof rests with the applicant to demonstrate that the circumstances warrant intervention (such as the exclusion of a minority shareholder from management). Moreover, as an equitable remedy, this will only be granted if the applicant who is seeking it has had no part in the matters that he complains of (this is called coming to the court with 'clean hands').²²² Further, such an order is only made on this type of application where there will be enough funds, following the payment of any company debts, to distribute amongst the shareholders once the company has been wound up.²²³

In conclusion, despite the fact that the UK has conducted three wholesale reviews of its company's law in 1895, 1989 and 1986, the provisions of both the old and new Company Acts seem to lack adequate enforcement mechanisms, to afford sufficient protection to minority shareholders. Whilst on the other hand, South Africa has

²¹⁸ Sykes op cit note 199 at 2.

²¹⁹ Ibid.

²²⁰ Ibid.

²²¹ Section 122(1)(g) Insolvency Act, 1986.

²²² Sykes op cit note 199 at 1.

²²³ Ibid at 2.

introduced a regime that is more efficient and effective in a number of ways. It is submitted that the UK should consider introducing appraisal rights as a form of minority protection based on best practice from jurisdictions such as South Africa, the United States and Canada.

VII MINORITY SHAREHOLDER PROTECTION IN SWAZILAND

Swaziland has a dual-legal system comprising Roman-Dutch law and customary law; and most investments are effected and governed by Roman-Dutch law and the judicial system generally upholds the sanctity of contracts. However, companies investing under the auspices of Swazi tradition and custom do not have the same judicial protections and remedies, as investments under the more commonly used Roman-Dutch law.

The company law in Swaziland is based on pieces of legislation from other jurisdictions namely, the United Kingdom as a result of being a former British colony; thus has inherited the English legal system as well as South Africa which has a mixed legal system which comprises of Roman-Dutch law and English law. The Companies Act of 2009, which replaced the outdated Companies Act of 1912, came into force on 1 April 2010. Its main objective is to streamline the establishment, incorporation and registration of companies as well as improve the management, administration and dissolution of companies; and put Swaziland's corporate laws in line with regional and international developments.

Traditionally, the governance of companies is based on the principle of majority rule which means that the minority shareholder has to submit to the will of the majority and only where decisions amounted to oppressive behaviour is a minority shareholder protected.²²⁴ Despite the principle of majority rule remaining an entrenched part in common law, new principles and regulations are gradually giving minority shareholders greater powers within companies.²²⁵

In addition to the principle of majority rule, a further principle of company law is that if a company has been wronged, it must itself act to have the wrong redressed.²²⁶ This principle is connected to the separate legal entity of a company.²²⁷ It is important to

²²⁴ J T Pretorius, P A Delpont & Michele Havenga *South African Company Law through Cases* 6ed (1999) 383.

²²⁵ *Ibid.*

²²⁶ In *Foss v Harbottle* 1843 2 Hare 461, 67 ER 189 at 204-04, Wigram VC stated:

"It was not, nor could it successfully be, argued that it was a matter of course for any individual members of a corporation thus to assume to themselves the right of suing in the name of corporation."

²²⁷ See *Salomon v Salomon & Co Ltd* 1897 AC 22.

note that it is highly improbable for the company to act in its own name, especially if the wrongdoers themselves are in control of the company.

Common law provides for two types of actions that minority shareholders can take to ascertain their rights, these are Derivative Action and Personal action; the choice of which action to use is dependent on the wrong done and the circumstances surrounding the wrong. In Swaziland, the derivative action of the common law has received little attention.

(a) Derivative Action

Minority shareholder protection under common law is centred on the famous case of *Foss v Harbottle*²²⁸; where the court held that the proper plaintiff in an action for a wrong done to the company is the company itself; this principle is known as the rule in *Foss v Harbottle*.²²⁹ This rule is based on the principle that a company has a separate legal personality to its shareholders and the majority rule. The effect of this judgment is that it rendered minority shareholders virtually powerless, if the acts complained off against the company were condoned by the majority²³⁰ because the minority shareholders were bound by the majority resolution and could not institute action against the wrongdoer.

It is the board of directors that has the authority to institute action in the name of or on behalf of the company.²³¹ The question that arises is what if a wrong to the company directly affects a shareholder? The strict operation of the rule in *Foss v Harbottle* would prevent a minority shareholder from protecting his/her interest. The common law exception to this rule is that shareholders may intervene and institute

²²⁸ (1843) 2 Hare 461; 67 ER 189.

²²⁹ *Ibid.*

²³⁰ ²³⁸ In *Edward v Halliwell* 1950 2 All ER 1064 CA 1066 Jenkins LJ states:

"The rule in *Foss v Harbottle*, as I understand it, comes to no more than this. First, the proper plaintiff in an action in respect of a wrong alleged to be done to a company or association of persons is Prima Facie the company or the association of persons itself. Secondly where the alleged wrong is transaction which might be made binding on the company or association and on all its members by simple majority of the members, no individual member of the company is allowed to maintain an action in respect of that matter for the simple reason that, if a mere majority of the members of the company or association is in favour of what has been done."

²³¹ Cassim et al op cit note 7 at 775.

action (derivative action) on behalf of the company where the board refuses or is unable to do so.²³²

The common law derivative action principle was developed in circumstances where those who commit a wrong against the company, for instance the company is defrauded by its directors, are also the majority shareholders and subsequently use their majority to prevent the company from instituting action to remedy the wrong done to the company.²³³ The plaintiff must join the company as a nominal defendant, making it a party to the proceedings; hence the order made becomes applicable to it. The applicant is personally liable for the legal costs involved in instituting the action and if successful, any benefit from the proceedings accrues to the company not to him personally. This may make members reluctant to institute proceedings.²³⁴

(b) Personal action

In the shareholders capacity as a member of the company, the personal action remedy grants the member the right to institute action against the company on his/her own behalf, as well as on behalf of the other members of the company in the following instances:²³⁵ (a) if there has been a breach of the rights of the member as they are protected under the memorandum or articles; (b) where there has been illegal conduct and conduct that is in breach of the common law which related to the member's, membership rights and which cannot be ratified by an ordinary resolution; (c) where there has been fraud on the minority and in addition to normal fraud, this also relates to the abuse of power by the majority.

Expecting minority shareholders under common law, who usually don't have access to vital information of the internal dealings of the company, to assert the rights of the company at their own cost by way of derivative action; is somewhat impractical²³⁶ and one of the reasons the legislature in Swaziland amended this piece of legislation to provide for statutory derivative action in the Companies Act.²³⁷

²³² *Ibid* at 776.

²³³ *Ibid*.

²³⁴ *Ibid* at 777.

²³⁵ K Walmesly *Company Law Handbook* (2008) 206.

²³⁶ M S Blackman, R D Jooste, & G K Everingham *Commentary on the Companies Act (Volume 2)* (2002) 90-103.

²³⁷ Swaziland Companies Act 8 2009.

Nowadays, in most instances, minority shareholders prefer to rely on statutory minority shareholder protection as enshrined in the Companies Act²³⁸. This will be discussed in further detail below.

(a) Statutory Derivative Action

Section 228 of the Companies Act²³⁹ facilitates the institution of proceedings on behalf of a company, by a member, against a director or officer or past director or officer of that company where a company has suffered damages or loss, or has been deprived of any benefit as a result of any wrong, breach of trust or breach of faith committed by any director or officer of that company or by any past director or officer while he was a director or officer of that company and the company has not instituted proceedings for the recovery of such damages, loss or benefit.²⁴⁰ The member must first serve a written notice on the company, calling on it to initiate such proceedings within one month from the date of service, failing which, he/she shall initiate the proceedings.²⁴¹

Should the company fail to initiate the proceedings within the said period, the member may make an application to the court for an order appointing a curator *ad litem* to institute and conduct the proceedings on behalf of the company, against such director or officer or past director or officer.²⁴² If the court is satisfied that the company has refused or failed to institute the proceedings; there are *prima facie* grounds for such proceedings. If the investigation into the grounds and the desirability of the institution of such proceedings is justified, the court may appoint a provisional curator *ad litem* and direct him/her to conduct the investigation and report to the court on the return day of the provisional order.²⁴³ On the return day, the court may discharge the provisional order, or confirm the appointment of the curator *ad litem*; as the court may deem necessary and may order that any resolution ratifying

²³⁸ Swaziland Companies Act 8 2009.

²³⁹ Swaziland Companies Act 8 2009.

²⁴⁰ Section 228(1).

²⁴¹ Section 228(2)(a).

²⁴² Section 228(2)(b).

²⁴³ Section 228(3)(a),(b) and (c).

or condoning the wrong, breach of trust or breach of faith or any act or omission in relation thereto shall not be of any force or effect.²⁴⁴

The basis for instituting this type of action is that, if it can be proved that the company has suffered any damages or loss or has been deprived any benefit owing to a wrong, breach of trust or faith committed by a current or present director or officer and it failed to institute proceedings against that director or officer; a provisional curator who reports his findings to the court will be appointed. If the court is satisfied with the findings, it will appoint a curator *ad litem* who will institute proceedings on behalf of the company against the wrongdoers.²⁴⁵

The introduction of statutory derivative action by the legislature does provide some form of protection to minority shareholders in that the court may order the company to pay the costs of the proceedings, where it is established that the institution of the action by the applicant was a reasonable and prudent course to take, in the interests of the company.²⁴⁶ In addition, the proceedings can be instituted despite that the wrong is rectifiable²⁴⁷ and the appointment of a curator *ad litem* will provide more information as, he/she has investigative powers.²⁴⁸

The shortcomings of this section, is that it is only applicable to wrongs in which the company has suffered; in the form of damages, loss or if it has been deprived of a benefit²⁴⁹; thus wrongs that have been inflicted on members or minority shareholders are not covered by this protection mechanism. It is worth noting that only certain types of wrongs are included under the section²⁵⁰ and members must resort to common law derivate action to assert their rights, in instances where the wrong is not covered by the Act and this action is only available if the company has not instituted proceedings against the wrongdoers. It is also important to note that proceedings can be initiated even if the company has passed a resolution ratifying or

²⁴⁴ Section 228(4).

²⁴⁵ A T Adebango *Remedies for Dissenting Shareholders: A Comparison of the Current Option of Personal Action and the Proposed Appraisal Remedy under the Companies Bill of 2008* (Unpublished LLM thesis, University of South Africa, 2008) 9.

²⁴⁶ Section 230.

²⁴⁷ Section 228(4).

²⁴⁸ Section 229(1) read with section 222.

²⁴⁹ Section 228(1).

²⁵⁰ *Ibid* and include breach of trust or breach of faith or any wrong.

condoning the wrong, breach of trust or breach of faith or any act or omission in relation thereto.²⁵¹

(b) Appointment of Inspectors

Section 219 provides that when the members apply to the Minister for the inspection of the company's affairs. The Minister may appoint an inspector or inspectors to investigate the affairs of the company and report thereon in such a manner as he/she may direct, under these circumstances: (a) in the case of a company limited by shares, on the application of not less than one-hundredth members or of members holding not less than one-twentieth of the shares issued²⁵²; and (b) in the case of a company limited by guarantee on the application of not less than one-tenth of the number of persons on the register of members.²⁵³ The application to the Minister must be supported by evidence as the Minister may require evidence/ proof that the applicants have good reason or are justified in desiring an inspection.²⁵⁴ The Minister also has a discretion whether or not to require the applicants to give security to his/her satisfaction, for an amount not exceeding four hundred emalangeni towards the cost of the investigation.²⁵⁵

The Minister may also appoint an inspector or inspectors to investigate the affairs of the company if it appears to him that there are circumstances suggesting; (a) that the business of the company is being conducted with intent to defraud its creditors or the creditors of any other person or otherwise for a fraudulent or an unlawful purpose or in a manner unfairly prejudicial or unjust or inequitable to any part of its members or that it was formed for any fraudulent or unlawful purpose;²⁵⁶ or (b) that the persons concerned with its formation or the management of its affairs have in connection therewith been guilty of any fraud, delict or other misconduct towards it or toward its

²⁵¹ Section 228(4).

²⁵² Section 219(1)(a).

²⁵³ Section 219(1)(b).

²⁵⁴ Section 219(2).

²⁵⁵ Ibid.

²⁵⁶ Section 220(2)(a).

members;²⁵⁷ or (c) that its members have not been given all the information with respect to its affairs, which they might reasonably expect.²⁵⁸

Although section 220 may seem to provide some form of protection for minority shareholders, in practice this section plays a limited role in protecting minority shareholders; as there have been no reported cases in Swaziland where this section has been invoked.

(c) Members remedy in case of unfairly prejudicial conduct

Section 214 provides that any member of a company who complains that any particular act or omission of a company is unfairly prejudicial, unjust or inequitable, or that the affairs of the company are being conducted in a manner unfairly prejudicial, unjust or inequitable to him or some part of the members of the company; may make an application to the court for an order²⁵⁹ where the act complained of relates to; (a) any alteration of the memorandum of the company under section 46 or 47;²⁶⁰ (b) any reduction of the capital of the company under section 69;²⁶¹ (c) any variation of rights in respect of shares of a company under section 86²⁶²; or (d) a conversion of a private company into a public company or of a public company into a private company under section 19.²⁶³

This remedy is designed to provide relief to oppressed shareholders without necessarily overruling the majority rule principle. However, the section does not abolish the common law personal action remedy that can be invoked by minority shareholders.

Once an application has been brought before the court and it appears to the court that the particular act or omission is unfairly prejudicial, unjust or inequitable or that the company's affairs are conducted with fraudulent intent, and if the court considers it is just and equitable, it may with a view of bringing to an end the matters

²⁵⁷ Section 220(2)(b).

²⁵⁸ Section 220(2)(c).

²⁵⁹ Section 214(1).

²⁶⁰ Section 214(2)(a).

²⁶¹ Section 214(2)(b).

²⁶² Section 214(2)(c).

²⁶³ Section 214(2)(d).

complained off make such an order as it deems fit.²⁶⁴ However, this remedy is only available to formally registered members of the company and the application to court has to be made within six weeks after the date of the passing of the relevant special resolution required, with regards to the particular act.²⁶⁵

(d) Power to acquire shares of minority in a take-over scheme.

Where a take-over has been made through a scheme or contract, that involved the transfer of shares or any class of shares of a company to an offeree, within four months after the offer was made and the offeror received no less than 90% of the shareholders' approval; the offeror may within two months after the acceptance, give notice to any shareholder who has not accepted the said offer of the desire to acquire his shares on the same terms as the offer accepted by the other shareholders. The shareholder who has not accepted the offer, can within 6 weeks of such notice approach the court which has the discretion to make an order it deems fit. If no application is made within the said period, the offeror is bound to acquire those shares of the shareholders who have not accepted the offer.²⁶⁶

Where a notice has been given by the offeror to the court on an application made by a shareholder who has not accepted the offer, has not ordered to the contrary, the offeror shall, on the expiration of 6 weeks from the date on which the notice was given, or, if an application to the court by such shareholder is then pending, after the application has been disposed of, transmit a copy of the notice to the offeree company. The notice to the offeree company must be accompanied by an instrument of transfer executed on behalf of such shareholder by any person appointed by the offeror and pay or transfer to the offeree company the amount or other consideration representing the price payable by the offeror for the shares which he or it is entitled to acquire, the offeree company shall thereupon register the offeror as the holder of

²⁶⁴ Section 214(3) whether for regulating the future conduct of the company's affairs or for the purchase of the shares of any members of the company by other members thereof or by the company and, in the case of a purchase by the company, for the reduction accordingly of the company's capital, or otherwise.

²⁶⁵ Section 214(2).

²⁶⁶ Section 268(1).

those shares; provided that an instrument of transfer shall not be required for any share for which a share warrant is for the time being outstanding.²⁶⁷

In this instance, a minority shareholder who dissents can be bought out if 90% of the shareholders voted for and accepted the offer from the offeror. This thereby means that in a take-over, minority shareholders who dissent, only have recourse to the courts which has the discretion to issue an order that it may deem fit. If the court issues an order against the minority shareholder, the offeror is entitled to acquire the minority shareholders' shares and thus the minority shareholder will not be afforded an opportunity of becoming an investor and holder of shares in the new company.

The possible remedies that Swaziland Company law can adopt to improve minority shareholder protection, in an attempt to strike a balance between protecting the interests of the majority shareholders and that of minority shareholders will be discussed below.

(a) Adoption of Donohue approach (heightened fiduciary duty)

One remedy that can be incorporated in Swaziland's Company law to improve minority shareholder protection, is the Donahue approach (Heightened fiduciary duty). This approach basically states that all shareholders owe each other a strict duty of the utmost loyalty and good faith. This approach has been supported by many cases in a number of foreign jurisdictions.

The leading case for this approach is the case of *Donahue v. Rodd Electrotupe Co. of Newingland Inc.*²⁶⁸ In this case the court held that 'Stockholders in a close corporation owe one another substantially the same fiduciary duty in the operation of the enterprise that partners owe to one another, namely, a duty of the utmost good faith and loyalty.²⁶⁹ Just as in a partnership, the relationship among the stockholders must be one of trust, confidence and absolute loyalty if the enterprise is to succeed.'²⁷⁰

²⁶⁷ Section 268(2).

²⁶⁸ 328 N.E.2D 505 (1975).

²⁶⁹ *Ibid* at 587.

²⁷⁰ *Ibid*.

This principle was also reaffirmed in the case of *Wilkes v. Springside Nursing Home, Inc.*²⁷¹, where it was held that stockholders in a close corporation owe one another the duty of utmost good faith and loyalty.

The Donohue approach has been prevalent in most states across the US and it is submitted that Swaziland is considering adopting this approach as a means to better protect minority shareholding. The use of this approach should be applied with consideration of the type of entity, as shareholders publicly held corporation have different expectations from the shareholders in closely held corporations. As such it is important when granting appropriate remedies in relation to the Donahue approach, to consider the different expectations of the shareholders.²⁷²

(b) Exit Mechanism

Another possible improvement to the current minority shareholder protection in Swaziland, is the set-up of an exit mechanism. Currently, under the Swaziland company law, there is no provision that compels the majority to buy out the minority shareholders in instances where a resolution is adopted but is potentially detrimental to the minority shareholders. Swaziland should consider adopting the appraisal remedy that has been adopted by South Africa, however it would be highly recommended to incorporate best practice from Delaware and Canada; as this would make the perfection procedure of the appraisal remedy more simplistic. This would ensure that the balance is struck between the protection of majority and minority shareholders and minority shareholders are afforded a 'way out' of the company.

In order to prevent companies from being held ransom by minority shareholders who want to make a quick profit and stifle the growth of the company, it is suggested that when a minority shareholder can force the majority to buy its shares, for example in instances where the decision adopted by the majority shareholders amounts to gross oppression of the minority shareholders.

²⁷¹ (370) Mass.842, 253 N.E.2d.657 [1976].

²⁷² A Lileka *An Investigation into Minority Share Protection in Namibia* (Unpublished LLB thesis, University of Namibia, 2011) 34.

VIII CONCLUSION

Historically, it has been shown that the appraisal remedy has served and continues to afford minority shareholders who enter into fundamental transactions, the necessary protection that they require. In the South African company law context, the Act has considerably liberalised fundamental transactions policy in its effort to grow the economy through efficient facilitation of majority approved business combinations. Although the perfection procedure in South Africa is complex, technical, time consuming and costly for minority shareholders; the best practice on how to simplify the perfection procedure from jurisdictions such as the US and Canada would be helpful in this regard.

With regards to Swaziland's Company law, there is a need for increased minority shareholder protection and a need for an amendment to the Act to include an appraisal remedy that better protects minority shareholders; especially with regards to fundamental transactions. However, this recommendation does not suggest that a wholesome transplant of the Company laws from other jurisdictions should be done, rather, best practice of the appraisal remedy from these jurisdictions should be emulated to improve the currently inadequate minority shareholder protection in Swaziland.

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