

THE TRIANGULAR MERGER STRUCTURES:

THE USE OF THE FORWARD AND REVERSE TRIANGULAR MERGER
STRUCTURES TO CIRCUMVENT THE VOTING AND APPRAISAL RIGHTS
OF MINORITY SHAREHOLDERS AND POTENTIAL SHAREHOLDER
REMEDIES

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In partial fulfilment of

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Supervisor: Jacqueline Yeats

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ABSTRACT:

The triangular merger structures provide an innovative and effective method for avoiding the voting and concomitant appraisal rights of a holding company's shareholders. This is because, by incorporating and making use of a wholly owned subsidiary company to effect the proposed transaction, the holding company is deemed not to be a party to the amalgamation or merger agreement; even though the transaction is instigated and financed by it. Importantly, and as a result of the fact that the holding company is able to distance itself from the transaction, its shareholders are deprived of their voting and appraisal rights, thereby allowing said company to effectively avoid the usual cash drain resulting from the exercise of shareholder appraisal rights.

It is argued that companies must not be allowed to make use of and exploit the separate legal personality of a shell subsidiary company solely to circumvent the rights of their shareholders. Failing specific legislative intervention to curtail this potential abuse, shareholders of the holding company ought to be able to successfully challenge the implementation of a triangular merger by (i) applying to court in terms of s 20(9) of the Act (the theory behind this being that the triangular merger structures propose the use of a separate legal entity as a device or stratagem to defeat their rights); and/or (ii) filing a complaint with the relevant statutory body citing the provisions of s 115(4) of the Act. In either case, and as an alternative submission, shareholders can also argue that such conduct falls within the parameters of the statutory oppression remedy.

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1. INTRODUCTION

The Companies Act 71 of 2008 ('the Act') ushered in the notion of a statutory amalgamation or merger procedure based on the principle of majority rule and offset by the appraisal rights of dissenting shareholders.¹ In essence, the statutory amalgamation or merger is a court-free process whereby two or more companies may agree to come together, provided the transaction is approved by the prescribed majority shareholders of each (recognised) participating company.² Yet, to counter the effect of majority rule and to attain a proper balance between the interests of all shareholders, dissenting minority shareholders are afforded the opportunity to opt out of their respective companies – and so too the proposed transaction – by invoking their appraisal rights.³ The end result is a seemingly perfect system of laws that is not only more conducive to corporate change but also mindful of the rights, expectations and desires of recalcitrant minority shareholders.

Viewed from the perspective of the companies wanting to effect an amalgamation or merger, the cash drain elicited by the exercise of shareholder appraisal rights may, however, impact negatively on their current cash liquidity and, ultimately, the financial viability of the transaction.⁴ For this reason, companies often identify the appraisal rights of dissenting shareholders as an unnecessary corporate expense that is best avoided;⁵ and so continually seek new and ingenious ways to circumvent the application thereof. As remarked by Medina J, the ingenuity of those at the helm of corporate affairs knows no limits.⁶

Two innovative and effective techniques for effecting an amalgamation or merger without triggering the voting and attendant appraisal rights of shareholders is the forward triangular merger structure and the reverse triangular merger structure

¹ Sections 113, 115, 116 and 164 of the Act.

² Sections 113(1) and 115(2) of the Act; Maleka Femida Cassim 'The introduction of the statutory merger in South Africa corporate law: Majority rule offset by the appraisal right (Part 1)' (2008) 20 *SA Merc LJ* 1 at 1; Farouk HI Cassim (managing ed), Maleka Femida Cassim, Rehana Cassim et al *Contemporary Company Law* 2 ed (2012) 677.

³ Section 115(8) read with s 164 of the Act; Farouk HI Cassim et al op cit note 2 at 676-78.

⁴ See, for example, Bayless Manning 'The shareholder's appraisal remedy: An essay for Frank Coker' (1962) 72 *Yale LJ* 223 at 234.

⁵ Ibid at 233-38.

⁶ 'Since the time to which the memory of man runneth not to the contrary the human animal has been full of cunning and guile. Many of the schemes and artifices have been so sophisticated as almost to defy belief. But the ordinary run of those willing and able to take unfair advantage of others are mere apprentices in the art when compared with the manipulations thought up by those connected in one way or another with transactions in securities', per Medina J in *Green v Santa Fe Industries* 533 F 2d 1283 (2d Cir, 1976) 1287.

(collectively referred to herein as ‘the triangular merger structures’). As will be explained in more detail,⁷ in a triangular or reverse triangular merger (collectively referred to herein as ‘a triangular merger’), the true would-be acquirer (ie the company effectively causing the transaction) is deemed not to be a party to the transaction and therefore its shareholders are not entitled to voting or appraisal rights.

Notwithstanding the general recognition that the triangular merger structures can be utilised by astute companies to avoid shareholder voting and appraisal rights, both structures enjoy widespread popularity in the United States of America,⁸ and will in all likelihood be preferred procedures for carrying out future business combinations in South Africa.⁹ But should companies be permitted to make use of the triangular merger structures primarily to defeat the appraisal rights of dissenting minority shareholders? If so, how can shareholders challenge the implementation of a triangular merger as a technique to intentionally defeat their rights? These two questions form the basis of this dissertation.

It is argued that companies must not be allowed to make use of and exploit the separate legal personality of a wholly owned shell subsidiary company solely to circumvent the voting and appraisal rights of their shareholders (note the use of the word ‘solely’), as is often the case when employing the triangular merger structures. Failing specific legislative intervention to curtail this potential abuse, shareholders of the true would-be acquirer ought to be able to successfully challenge the planned implementation of a triangular merger by (i) applying to court in terms of s 20(9) of the Act (the theory behind this being that the triangular merger structures propose the use of a separate legal entity as a device or stratagem to defeat their voting and attendant appraisal rights); and/or (ii) filing a complaint with the relevant legislative body citing the provisions of s 115(4) of the Act. In either case, and as an alternative submission, shareholders can also contend – although the success of such a submission is particularly uncertain – that the use of the triangular merger structures solely to circumvent their aforementioned rights falls within the parameters of s 163 of the Act, ie the oppression remedy.

⁷ See Chapter 3 below.

⁸ Ronald J Gilson & Bernard S Black *The Law and Finance of Corporate Acquisitions* 2 ed (1995) 670; Farouk HI Cassim et al op cit note 2 at 705.

⁹ Maleka Femida Cassim op cit note 2 at 29.

This dissertation is divided into two main parts. Part A is dedicated to an overview of relevant aspects of the appraisal remedy and an analysis of the statutory amalgamation or merger provision. While in Part B the methods whereby recalcitrant minority shareholders may contest the carrying out of a triangular merger are considered.

Part A comprises three chapters. Chapter 2 consists of an overview of the appraisal remedy. The objective of Chapter 2 is twofold. First, to stress the intended purpose of shareholder appraisal rights; and, secondly, to emphasise the limited scope and application of a remedy that was developed – and is generally regarded – as the primary protective measure for shareholders opposed to an amalgamation or merger. Next, in Chapter 3, pertinent aspects of the new statutory amalgamation or merger provision will be discussed and analysed. The chapter will commence with a general overview of amalgamations and mergers so as to underscore the features that distinguishes the new legislative provision from the more traditional modes of effecting business combinations. Thereafter, the relevant statutory provisions pertaining to amalgamations or mergers will be analysed, with particular reference to the four inherent shareholder protective measures. This is followed by a review of the various types of merger consideration permitted under the Act. In this regard, it will be noted that the Act envisions not only the traditional exchange of shares by and between the constituent companies as an acceptable form of merger consideration, but also the exchange of shares in another company and/or cash. These alternative forms of merger consideration seemingly permit the very useful triangular merger structures, which will be analysed in detail. To conclude Part A, the tendency to award shareholder rights based solely on the structure of a transaction will be debated.

Part B is structured as follows: in Chapter 4 the use of s 20(9) of the Act as the first of the proposed shareholder remedies is discussed. Chapter 4 commences with a general overview of the doctrine of ‘piercing’ or ‘lifting’ the corporate veil, as developed under the common law, whereafter the recent statutory codification of said doctrine is analysed. Thereafter, the application of the aforementioned doctrine in the context of company groups will be discussed with reference to apposite judicial decisions. The objective is to make evident that it is well within the powers of a court of law to disregard the separate legal personality of a company – provided the relevant

facts warrants such action. It must be emphasised that, since companies may choose to make use of the triangular merger structures for reasons other than to circumvent the voting and appraisal rights of its dissenting minority shareholders,¹⁰ the facts of each matter are of paramount importance. To highlight the aforesaid, two hypothetical scenarios will be considered. In Chapter 5 the second potential shareholder remedy (that is, filing a complaint with the relevant regulatory agency based on the provisions of s 115(4) of the Act) will be discussed. This discussion will centre on the role of the Takeover Regulation Panel ('the Panel') and the Companies and Intellectual Property Commission ('the Commission'), and the prerogative of said statutory bodies to ensure the fair treatment of all shareholders. Akin to Chapter 4, the analysis will conclude with a consideration of two hypothetical scenarios so as to highlight important differences between the Panel and the Commission. The US-styled *de facto* merger provision will be considered in Chapter 6. Since the said doctrine is a product of the US judiciary, the discussion will centre mostly on three important judgments emanating from that country and the role each played in the development and subsequent decline of the doctrine. Chapter 7 encompasses a brief overview of the oppression remedy. A detailed analysis of the aforementioned shareholder remedy will not be attempted (the scope of this dissertation simply does not allow for it). Instead, only the most pertinent aspects of the remedy will be discussed in order to consider (briefly) the scope and application thereof as an additional submission (ie a plea in the alternative) by disgruntled shareholders. It must be emphasised that the principal purpose of Chapter 7 is merely to call attention to, and take cognisance of, what is considered an essential shareholder remedy. Chapter 8 concludes the dissertation.

¹⁰ See Chapter 3.6 below.

PART A:
THE STATUTORY RIGHT OF APPRAISAL & AMALGAMATION OR MERGER
PROVISION

2. THE APPRAISAL REMEDY

2.1 Introduction

It is trite law that by becoming a shareholder in a company a person accepts to be bound by the legitimate decisions of the prescribed majority shareholders.¹¹ As observed by Trollop JA in *Sammel v President Brand Gold Mining Co Ltd*:¹²

By becoming a shareholder in a company a person undertakes by his contract to be bound by the decisions of the prescribed majority of shareholders, if those decisions on the affairs of the company are arrived at in accordance with the law, even where they adversely affect his own rights as a shareholder...That principle of the supremacy of the majority is essential to the proper functioning of companies.¹³

While the majority shareholders may inspire actions that are inconsequential, others may cause a significant and fundamental change to the original rights and expectations of the company's minority shareholders.¹⁴ In the event of the latter, the obvious solution for dissenting minority shareholders is to withdraw from the company by selling their shares. A private sale may be difficult to accomplish, however, since few investors would be interested in acquiring a minority stake in a business, or because the company's Memorandum of Incorporation expressly prohibits its shareholders from disposing of their shares on the open market (as is the case with private companies¹⁵). Hence the statutory right of appraisal.¹⁶

Although the right of appraisal is a fundamentally new concept in South African law, it has been an enduring feature of US law since the seminal case of *Lauman v*

¹¹ See, for example, Mark Audrey Weinberg, *MV Blank & AL Greystone Takeovers and Mergers* 4 ed (1979) para 1401.

¹² 1969 (3) SA 629 (A).

¹³ At 678.

¹⁴ HGJ Beukes 'An introduction to the appraisal remedy as proposed in the Companies Bill: Triggering actions and the difference between the appraisal remedy and existing shareholder remedies' (2008) 20 *SA Merc LJ* 479 at 479.

¹⁵ See, inter alia, s 8(2)(b)(ii) of the Act.

¹⁶ See, for example, Beukes op cit note 14 at 479.

*Lebanon Valley Railroad Co*¹⁷ and the statutes that followed shortly thereafter in 1861,¹⁸ and has already been incorporated into the corporate statutes of Canada¹⁹ as well as New Zealand.²⁰ Consequently, South Africa's courts will be able to draw on a plethora of foreign judicial decisions and academic writings so as to interpret, apply, and give expression to the legislator's intention.²¹

2.2 Definition

The appraisal right can be defined as the right of a shareholder who is opposed to certain triggering events to have his or her or its shares bought out by the company in cash, at what is either a mutually agreed or judicially set fair price.²² The right is triggered, in broad terms, only when (and if) the company proposes and subsequently adopts (by way of its prescribed majority shareholders) a special resolution to alter the preferences, rights, limitations or other terms of a particular class of its shares, or to (i) dispose of all or the greater part of its assets or undertaking; (ii) *amalgamate or merge*; or (iii) effect a scheme of arrangement (ie if the company proposes to enter into one of the recognised fundamental transactions²³).²⁴ The aforesaid actions are collectively referred to hereafter as 'triggering transactions'.

It follows from the above that the right of appraisal is not a right of general application. On the contrary, the right is dependent on the actions of the company, hence the reference thereto as a 'no-fault remedy',²⁵ and is available to only those shareholders who observed all of the procedural requirements set out in the Act, including the obligation to vote against the proposed triggering transaction.²⁶

¹⁷ 30 Pa 42 (1858).

¹⁸ See, for example, *Farris v Glen Alden Corporation* 143 A 2d 25 (Pa, 1958) at 29; Manning op cit note 4 at 246-47 footnote 38. However, see Melvin Aron Eisenberg *The Structure of the Corporation* 3 ed (1976) 75, in which it is submitted that the first appraisal statute was passed as early as 1851 by the US state of Ohio.

¹⁹ See section 190 of the Canada Business Corporations Act RSC 1985 CC-44.

²⁰ See section 110 of the New Zealand Companies Act 1993 No 105.

²¹ Such an approach is in accordance with s 5(2) of the Act.

²² Section 164 of the Act; Beukes op cit note 14 at 479; Farouk HI Cassim et al op cit note 2 at 796.

²³ The phrase 'fundamental transaction' is not defined in the Act. Nevertheless, it is plain from an overview of the Act that the term is a generic phrase given to all types of transactions listed in Part A of Chapter 5 thereof, see Dennis Davis (ed), Farouk Cassim (ed), Walter Geach (managing ed) et al *Companies and Other Business Structures in South Africa* (2009) 151.

²⁴ Section 164(2) of the Act. Note that the right of appraisal does not apply if the transaction, agreement or offer is pursuant to an approved business rescue plan, see s 164(1) of the Act.

²⁵ Farouk HI Cassim et al op cit note 2 at 796.

²⁶ Section 164(2) read with s 164(5) of the Act. The interdependency between the right to vote and the right of appraisal is discussed in Chapter 2.4 below.

2.3. Underlying rationale

The appraisal remedy is inspired by two broad beliefs. On the one hand, majority shareholders require adequate scope to alter the company or company group in line with current market trends and requirements; on the other, minority shareholders are desirous to preserve their original investment and expectations. In order to attain the appropriate balance between the aforesaid needs of the majority and desires of the minority, triggering transactions may be effected by the company if supported by the prescribed majority of its shareholders; however, as a quid pro quo, the company's dissenting minority shareholders are assigned appraisal rights and thus a means to withdraw from the company upon terms that are seemingly fair and reasonable.²⁷ As such the appraisal remedy represents a compromise.²⁸

Yet the need for shareholder appraisal rights has, and will continue, to provoke great debate.²⁹ Due to the limited scope of this dissertation, however, the ensuing sub-chapters provide only an overview of the most pertinent arguments for and against the grant of appraisal rights. The objective is to emphasise the nature of the appraisal remedy as a valuable shareholder protective measure, as well as the principal reasons for wanting to avoid the effects thereof.

2.3.1 Selected arguments in favour of the appraisal remedy

Proponents of the appraisal remedy forward three main arguments for its existence, each of which is discussed in turn below. These explanations are all the more important and must be understood, since the appraisal remedy – not the sanction of the courts – will in future function as the primary protective measure for minority shareholders opposed to an amalgamation or merger.³⁰

²⁷ Maleka Femida Cassim 'The introduction of the statutory merger in South Africa corporate law: Majority rule offset by the appraisal right (Part 2)' (2008) 20 *SA Merc LJ* 147 at 158; Farouk HI Cassim et al op cit note 2 at 796-97.

²⁸ See, for example, *Chicago Corporation v Munds* 172 A 452 (Del Ch, 1934); *Anderson v International Minerals & Chemical Corporation* 67 NE 2d 573 (NY, 1946), wherein it was stated at 576 that: 'The purpose of [the statutory right of appraisal] was to protect dissenting shareholders, and the process of appraisal was designed to meet two evils which arose because of limitations upon the powers of majority shareholders to bind the minority to a course of action...'

²⁹ See, for example, Manning op cit note 4 at 223-65; Eisenberg op cit note 18 at 69-84.

³⁰ See, for example, Farouk HI Cassim et al op cit note 2 at 675.

(a) The defeated expectations argument

The defeated expectations argument most accurately illustrates the initial logic behind the grant of shareholder appraisal rights. The argument, so it goes, is that an investor who purchases shares in a company with a certain identity and business strategy ‘may rightfully expect to continue as investor in that enterprise’, hence no company should be able to compel an initial investor (who, it must be stressed once more, invested in a particular company with a particular identity) ‘to become an investor in a quite different business’.³¹ Accordingly, the appraisal remedy provides an exit mechanism for disgruntled shareholders, in the absence of which they will be confined to the new corporate enterprise.

(b) Remedy-for-unfairness argument

Following the introduction of cash as an acceptable form of merger consideration, the proponents of the appraisal remedy argue that it functions as a remedy against unfair treatment. For instance, if a recalcitrant minority shareholder feels dissatisfied with the price offered by the company for his or her or its shares, then said shareholder may rely on the appraisal remedy to challenge and dispute the fairness of the company’s offer.³²

The ability to challenge the price offered by the company is particularly important considering that the transaction (and thus the consideration payable to the dissenting minority shareholders) is negotiated and concluded by the company’s board of directors – which, though acting in the best interests of the company as a whole, may fail to act in the best interests of the (potential dissenting) minority shareholders by incorrectly (whether intentionally or negligently) appraising the value of the latter’s shares.³³

(c) The locus poenitentiae argument

According to this argument, the appraisal remedy serves as a deterrent against bad business decisions by the company’s board of directors. To elaborate, it is said that a company’s board may occasionally negotiate and be willing to settle ‘on terms that

³¹ Robert Charles Clarke *Corporate Law* 2 ed (1986) 444.

³² See, for example, *ibid* at 445. This is also evident from s 164(14)(b) of the Act.

³³ The directors may also fail to act in the best interests of the company as a whole (due to ‘side-payments’, for example), as suggested by Farouk HI Cassim et al *op cit* note 2 at 797.

are not the best that could be obtained'.³⁴ The more shareholders who believe this to be true, the more will exercise their appraisal rights. Since the foregoing will have an impact on the company's finances, the board will often feel compelled to reassess the feasibility of the proposed transaction and, if necessary, resile from the transaction.³⁵ Consequently, although the right of appraisal is primarily concerned with providing minority shareholders a way to get out of the company, it can also be used by them to challenge the decisions of the board, thereby potentially altering the course of the company.

2.3.2 Selected arguments against the appraisal remedy

Critics of the appraisal remedy generally forward three arguments to challenge the supposed need for appraisal rights. For present purposes, however, only two arguments will be considered.³⁶ The first is frequently referred to as 'the cash drain argument' and emphasises what is perhaps the primary reason why companies seek to avoid shareholder appraisal rights. The second is termed 'the stock market argument'. The reason for referring to this second argument is because it touches on the scope of the appraisal remedy.

(a) The cash drain argument

Viewed from the perspective of the company (or the majority shareholders), the right of appraisal is often perceived as an unwanted expenditure and deterrent to corporate change. This is because the obligation to repurchase its own shares from recalcitrant shareholders prior to the implementation of the triggering transaction may result in a severe cash drain. What is more, the demand for a cash pay-out comes at a time when the company may very well be in need of all of its cash resources to execute the planned transaction. Accordingly, depending on the financial position of the company, the cash drain (whether actual or anticipatory) may stymie the planned transaction altogether.³⁷

³⁴ Clarke op cit note 31 at 445.

³⁵ Ibid at 445-46; Farouk HI Cassim et al op cit note 2 at 797.

³⁶ The third argument, that is 'the consistency argument', underscores the fact that not all major transactions give rise to appraisal rights. For example, in the US a disposal of all or the greater part of a company's assets generally does not give rise to the right of appraisal, see the cases discussed in Chapter 6 below.

³⁷ Manning op cit note 4 at 233-38. See also FH Buckley, Mark Gillen & Robert Yalden *Corporations: Principles and Policies* 3 ed (1995) at 1001 where the authors state the following regarding the potential 'deal ending effect' of the appraisal remedy: 'But the possibility of large

The appraisal procedure itself may further contribute to the company's growing expenditures since prior to the implementation of an amalgamation or merger the company must provide its shareholders with various notices pertaining to the transaction and convene a shareholder's meeting,³⁸ resulting in an extra administrative and cost burden for the company.³⁹

In short, therefore, the appraisal remedy affects a company's bottom line, thus it is not surprising that companies will make every effort to avoid the effects thereof.⁴⁰

(b) The stock market argument

Critics of the appraisal remedy point out that, unlike the shareholders of private companies,⁴¹ shareholders of public companies⁴² are, as a rule, at liberty to sell their shares on the open market as and when they decide to do so. This has motivated some states in the US, including Delaware – the leading jurisdiction with regard to commercial law in the US – to implement so called 'stock market exception provisions', whereby the shareholders of public companies that are listed on a national

appraisal claims may deter some firms from entering into a triggering action. Evidence of this is provided by frequent conditions in amalgamation [or merger] agreements that the transaction may be abandoned if a specified number of shareholders (often [five per cent]) decide to appraise out'. However, see Clarke *op cit* note 31 at 446 where the author states that: 'This turns out to be merely a debater's point...No one seems to have carried out a sophisticated study of this empirical question'. Interestingly, as a practical example, see *Farris supra* note 18 at 31 footnote 5, where the following was noted by the court: 'Counsel for the defendants concedes that if the corporation is required to pay the dissenting shareholders the appraised fair value of their shares, the resultant drain of cash would prevent [the defendant] from carrying out the agreement'.

³⁸ Section 164(2), (3) and (4) read with s 113(5) of the Act.

³⁹ Also, the process of determining the fair value can result in further legal and/or professional expenses for the company, see, for example, Farouk HI Cassim *et al op cit* note 2 at 798.

⁴⁰ It must also be kept in mind that, if a company is unable to meet the financial burden placed on it by the exercise of shareholder appraisal rights, it can, in terms of s 164(17) of the Act, apply to court for an order varying its obligations, provided there are reasonable grounds to believe that the company will be unable to honour its debts as they become due and payable for a period of 12 months after the implementation of the transaction.

⁴¹ The term 'private company' is defined in s 1 of the Act as meaning: '[A] profit company that (a) is not a public, personal liability, or state-owned company; and (b) satisfies the criteria set out in section 8(2)(b)', which stipulates that: 'A profit company is a private company if... (ii) its Memorandum of Incorporation (aa) prohibits it from offering any of its securities to the public; and (bb) restricts the transferability of securities'.

⁴² The term 'public company' is defined in s 1 of the Act as meaning: '[A] profit company that is not a state-owned company, a private company or a personal liability company'. A public company is thus defined by exclusion in the sense that it is neither a private company, nor any other type of profit company. The main characteristic of a public company is that its shares may be freely offered to the public and, by and large, freely traded, see Farouk HI Cassim *et al op cit* note 2 at 78.

stock exchange and/or has more than a prescribed number of shareholders⁴³ are not afforded appraisal rights.⁴⁴

Yet the benefit of stock market exception provisions is disputed.⁴⁵ The following extract from *Chicago Corporation v Munds*⁴⁶ highlights but one of the arguments against the use thereof:

When it is said that the appraisal which the market puts upon the value of the stock of an active corporation as evidenced by its daily quotations, is an accurate, fair reflection of its intrinsic value, no more than a moment's reflection is needed to refute it. There are too many accidental circumstances entering into the making of the market prices to admit them as sure and exclusive reflectors of fair value...Markets are known to gyrate in a single day. The numerous causes that contribute to their nervous leaps from dejected melancholy to exhilarated enthusiasm and then back again from joy to grief, need not be reviewed...market quotations are not safe to accept as unerring expressions of value.⁴⁷

Besides, even if one is to assume that the market is able to correctly value the share price, simply remitting a dissenting shareholder to the market will not provide adequate protection if, for example, 'the very effect of the structural change is to depress the market price of the stock because the change is an ill-considered one'.⁴⁸ Notably, the foregoing has motivated the drafters of the US's Model Business Corporation Act 1984, as amended, to abandon the use of a stock market exception provision.⁴⁹

As it stands, the Act affords appraisal rights to the shareholders of private as well as public companies.⁵⁰ Superficially, at least, this appears to be a contentious pronouncement, and it remains to be seen whether the failure to distinguish between

⁴³ For example, the state of Delaware restricts the number to 2 000 shareholders, see s 262(1)(ii) of the Delaware General Corporation Law, 2001.

⁴⁴ See, for example, James D Cox & Thomas Lee Hazen *Corporations* 2 ed (2003) at 625.

⁴⁵ See, for example, Eisenberg op cit note 18 at 79-84; Jeff Goetz 'A dissent dampened by timing: How the stock market exception systematically deprives public shareholders of fair value' (2009) 15 *Fordham Journal of Corporate and Financial Law* 771.

⁴⁶ *Chicago Corporation* supra note 28.

⁴⁷ At 455.

⁴⁸ Eisenberg op cit note 18 at 82.

⁴⁹ See, for example, William Meade Fletcher *Fletcher Cyclopedia of the Law of Private Corporations* vol 15 (1990) at 402. Interestingly, neither Canada nor New Zealand has adopted stock market exception provisions.

⁵⁰ No distinction is made in s 164 of the Act between public and private companies. See also Farouk HI Cassim et al op cit note 2 at 799.

the shareholders of private and public companies will motivate the latter to make use of the triangular merger structures so as to avoid the cash drain occasioned by the exercise of shareholder appraisal rights.

2.4 Locus standi in iudicio

A person must be a dissenting shareholder of a profit company to have the necessary legal standing to rely on s 164 of the Act.⁵¹ The term ‘shareholder’ is defined in the Act as meaning ‘the holder of a share issued by a company and who is entered as such in the certificated or uncertificated securities register, as the case may be’.⁵² The term ‘share’ is defined as meaning ‘one of the units into which the proprietary interest in a profit company is divided’.⁵³ It follows from the foregoing that the term ‘shareholder’ does not include a stockholder of a non-profit company.⁵⁴ In addition, s 10(2)(h) of the Act expressly stipulates that the appraisal remedy does not apply to non-profit companies, except to the extent that the non-profit company is itself a shareholder of a profit company.

More importantly for purposes hereof, a shareholder, as defined above, may only demand that the company pay him or her or it the fair value for all of his or her or its shares held in that company if the company adopted the necessary resolution pertaining to the proposed triggering transaction and the shareholder has, inter alia, voted against the resolution.⁵⁵ Hence the right to vote is an essential prerequisite for the right of appraisal.

If an applicant does not comply with the abovementioned statutory requirements, he or she or it has no locus standi and will, therefore, not be entitled to rely on the appraisal remedy for relief.

2.5 Conclusion

Considering that the right of appraisal affords shareholders a way to opt out of the company as well as a means to ensure fair dealings, it is generally regarded as a

⁵¹ This is within the context of amalgamations or mergers. A further requirement, that is that the person must be the holder of shares materially altered by an amendment to the company’s Memorandum of Incorporation, is irrelevant for purposes hereof, see 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 177.

⁵² Section 1 of the Act.

⁵³ Section 1 of the Act.

⁵⁴ HGJ Beukes op cit note 51 at 177.

⁵⁵ Section 164(2) read with s 164(5) of the Act.

shareholder remedy. However, the remedy also paved the way for companies to effect fundamental corporate change without court approval or the unanimous consent of their shareholders: no longer can a company's minority shareholders (or a single shareholder for that matter) veto fundamental change. Instead, if a shareholder is opposed to change, he or she or it may withdraw from the company by exercising his or her or its right of appraisal – without interrupting the transaction.⁵⁶ Yet despite the obvious advantage resulting from the incorporation of the right of appraisal, the remedy is still viewed by some at the helm of corporations as a deterrent to change and hence the concerted effort to avoid its affects.

The best way for companies to avoid the consequences of the appraisal remedy, is to ensure that it cannot be invoked in the first place. In other words, if a company deprives its shareholders of their legal standing, the company also deprives its shareholders of the opportunity to enforce their appraisal rights. As will be explained in Chapter 3, below, the triangular merger structures enable companies to achieve such an end. Accordingly, with the necessary foresight and planning, companies are able to use the requirements of the appraisal remedy to circumvent the appraisal rights of their shareholders.

3. AMALGAMATIONS AND MERGERS

3.1 Introduction

The notion of a statutory procedure whereby two or more companies may combine subject mainly to the will of the prescribed majority shareholders and without the mandatory need for court approval is entirely novel to South African law. Analogous to the statutory appraisal remedy, ss 113, 115 and 116 of the Act (ie the statutory amalgamation or merger provisions) are predominantly based on the corporate laws of the US, and represent a contemporary approach founded on the general principle of majority rule.⁵⁷ It is anticipated that by providing companies with an efficient, swift and cost-effective way of attaining complete ownership of another company or companies, the new amalgamation or merger procedure will greatly encourage

⁵⁶ Cox & Hazen op cit note 44 at 620; *Anderson* supra note 28 at 576-77.

⁵⁷ See, for example, Ezra Davids, Trevor Norwitz and David Yuill 'A Microscopic analysis of the new merger and amalgamation provision in the Companies Act 71 of 2008' (2010) *Acta Juridica* 337 at 340-41. In the context of amalgamations and mergers the better term is perhaps 'supermajority rule', see Chapter 3.3.2 (b) below regarding the voting requirements.

corporate change and restructuring in the interest of economic growth and prosperity.⁵⁸

As will be explained in more detail below, amalgamations and mergers are regularly complex proceedings; however, for purposes hereof, the standard two-party amalgamation or merger transaction, in terms of which one of the participating companies is acquired by and fused into the other participating company, will be utilised to explain the general consequences of a corporate fusion.

3.2 General definition and effect

In general, an amalgamation or merger may be defined as a transaction whereby the assets and liabilities of two or more participating companies (termed ‘the constituent companies’) come to be vested in, or under the control of, a single acquiring company (termed ‘the surviving merged company’), which may or may not be one of the original constituent companies, and which has as its shareholders all, or substantially all, of the shareholders of the original constituent companies.⁵⁹

What sets the new statutory amalgamation or merger apart from the traditional modes of effecting business combinations⁶⁰ (as well as the other types of fundamental transactions) is that it provides for the total and automatic absorption of all the assets and liabilities of the target company into the acquiring company,⁶¹ and the automatic dissolution of the target company (termed ‘the disappearing company’).⁶² As noted by Dickenson J in *R v Black & Decker Manufacturing Co*,⁶³ the outcome is a total fusion of the constituent companies by operation of law:

It is a joining of forces and resources in order to perform better in the economic field... [T]he end result is to coalesce to create a homogeneous whole. The analogies of a river formed by the confluence of two streams, or the creation of a single rope through the intertwining of strands have been suggested by

⁵⁸ See, for example, Maleka Femida Cassim op cit note 2 at 1; Farouk HI Cassim et al op cit note 2 at 677. See also Weinberg op cit note 11 para 112-21 and para 301-45 for a discussion as to the general advantages and causes of amalgamations and mergers.

⁵⁹ Weinberg op cit note 11 para 104; HS Cilliers, ML Benade, JJ Henning et al *Corporate Law* 3 ed (2000) 460; Farouk HI Cassim et al op cit note 2 at 677.

⁶⁰ Previously, business combinations could be effected by way of (i) a tender offer and the sale of the business as a going concern; or (ii) a scheme of arrangement. Both methods envisaged the acquisition of shares (and thereby control of the target company) but not the total and automatic absorption of the target company into the acquiring company.

⁶¹ Section 116(7)(a) of the Act.

⁶² Section 116(5)(b) of the Act.

⁶³ [1975] 1 SCR 411 (SCC).

others...The effect...is to have the amalgamating companies continue without subtraction in the amalgamated corporation, with all their strengths and weaknesses, their perfections and imperfections and their sins, if sinners they be.⁶⁴

3.3 Effecting an amalgamation or merger whilst protecting the interests of dissenting minority shareholders

Even though the statutory amalgamation or merger is centred on a long-standing principle (that is, majority rule), it denotes a significant liberalisation of policy in favour of the majority shareholders. Consequently, in an attempt to attain the necessary balance between the interests of all shareholders, various protective measures have been incorporated into the Act.⁶⁵ What follows is an analysis of the statutory amalgamation or merger and the aforementioned inherent shareholder protective measures.

3.3.1 The statutory amalgamation or merger

Section 113(1) of the Act authorises two or more profit companies to amalgamate or merge.⁶⁶ In addition, the Act specifies what matters must be included in the obligatory amalgamation or merger agreement, the procedure that must be followed in order to successfully implement an amalgamation or merger, as well as the general effect of implementing an amalgamation or merger.⁶⁷

The phrase ‘amalgamation or merger’ is defined in s 1 of the Act as meaning:

[A] transaction, or series of transactions, pursuant to an agreement between two or more companies, resulting in –

- (a) The formation of one or more new companies, which together hold all of the assets and liabilities that were held by any of the amalgamating or merging companies immediately before the implementation of the agreement, and the dissolution of each of the amalgamating or merging companies; or
- (b) The survival of at least one of the amalgamating or merging companies, with or without the formation of one or more new companies, and the

⁶⁴ At 421-22.

⁶⁵ Farouk HI Cassim et al op cit note 2 at 700-01.

⁶⁶ Section 113(1) of the Act reads as follows: ‘Two or more profit companies, including holding and subsidiary companies, may amalgamate or merge if, upon implementation of the amalgamation or merger, each amalgamated or merged company will satisfy the solvency and liquidity test’.

⁶⁷ Sections 113, 115 and 116 of the Act.

vesting in the surviving company or companies, together with any such new company or companies, of all of the assets and liabilities that were held by any of the amalgamating or merging companies immediately before the implementation of the agreement.

The Act thus provides for two broad amalgamation or merger structures. In terms of the first structure, all of the assets and liabilities belonging to the amalgamating or merging companies⁶⁸ (ie the constituent companies) are transferred to a new company ('Newco'), which is incorporated in accordance with and on implementation of the amalgamation or merger agreement. Subsequent to the implementation of the amalgamation or merger, Newco remains in existence and carries on the combined business operations of the original constituent companies as the surviving merged company; whereas the original constituent companies are dissolved by operation of law. In contrast, the second structure does not entail the incorporation of a new surviving merged company. Instead, one of the constituent companies will assume the role of the surviving merged company and, in so doing, take transfer of all the assets and liabilities belonging to the other constituent company, which will be dissolved by operation of law.⁶⁹

Two further points must be noted with reference to the statutory definition of an amalgamation or merger. First, it is evident that an amalgamation or merger can become rather complex. This is because the Act does not limit the number of amalgamating or merging companies and provides for the formation of one or more new companies or the survival of at least one of the amalgamating or merging companies. As a result, not only can there be more than two constituent companies but also more than one surviving merged company.⁷⁰ (However, as stated earlier, only the standard two-party merger structure will be employed herein.) Secondly, the Act draws no distinction between an amalgamation, on the one hand, and a merger, on the other. This is despite the fact that the draft Companies Bill, 2007 ('the draft Bill') did differentiate between the two terms. Under the draft Bill, the transaction contemplated in s 1(a) of the Act (ie the incorporation of a new company) was defined as an amalgamation, whereas the transaction contemplated in s 1(b) of the Act (ie the

⁶⁸ The phrase 'amalgamating or merging company' is defined in s 1 of the Act as meaning: '[A] company that is a party to an amalgamation or merger agreement'.

⁶⁹ Farouk HI Cassim et al op cit note 2 at 678.

⁷⁰ Ibid at 680.

transfer of assets and liabilities to one of the existing constituent companies) constituted a merger.⁷¹ A similar distinction is generally advocated and applied in the US, albeit the use of the term ‘consolidation’ instead of ‘amalgamation’.⁷²

3.3.2 Overview of the amalgamation or merger procedure

The amalgamation or merger procedure may be divided into the following three essential steps: (i) the negotiation and approval of an amalgamation or merger agreement by the board of directors of each constituent company and the drafting of a formal agreement that complies with the requirements of the Act (‘the amalgamation or merger agreement’); (ii) the submission of the amalgamation or merger agreement, or a summation thereof, to the shareholders of each constituent company for their approval at a meeting called for such purpose; and (iii) the implementation of the amalgamation or merger agreement and the giving of the requisite notices to every known creditor of each constituent company as well as to the Commission.⁷³

Once the amalgamation or merger agreement is approved by the specified majority of shareholders, it creates binding contractual obligations between the parties thereto. Hence any person to whom assets are, or an undertaking is, to be transferred may apply to court for an order giving effect to the amalgamation or merger agreement.⁷⁴ In the US shareholders have attempted to rescind an amalgamation or merger, though such efforts have generally been unsuccessful.⁷⁵ Instead, the better option for recalcitrant shareholders is to obtain a court order prohibiting the implementation of the transaction.⁷⁶ Therefore, if it is accepted that South African courts will follow a similar approach as its American counterparts (which is most probably the case), the inherent protective measures, as encompassed in the Act, are

⁷¹ Clause 1 of the draft Bill; Maleka Femida Cassim op cit note 2 at 2.

⁷² See, for example, *Metropolitan Edison Co v Commissioner of Internal Revenue* 98 F 2d 807 (3d Cir, 1938); Fletcher op cit note 49 at 8.

⁷³ See sections 113, 115 and 116 of the Act; Cox & Hazen op cit note 44 at 608.

⁷⁴ Section 115(9) of the Act.

⁷⁵ See, for example, *McMillan v Intercargo Corp* 768 A 2d 492 (Del Ch, 2000), wherein it was said that once the transaction has been implemented, the ‘metaphorical merger eggs have been scrambled. Under our case law, it is generally accepted that a completed merger cannot, as a practical matter, be unwound’. Even if the applicant shareholder makes out a case for rescission of the agreement, courts are generally disinclined to grant such an order. Instead, the claim is usually treated as ‘a suit for the value of the shareholder’s interest as fixed by a judicial, non-statutory appraisal’, ie the shareholder is compensated financially. See also Cox & Hazen op cit note 44 at 618.

⁷⁶ See, for example, *Gimbal v Signal Companies Inc* 316 A 2d 599 (Del Ch, 1974); *Electronic Speciality Co v International Controls Corp* 409 F 2d 937 (2d Cir, 1969).

of extreme importance to recalcitrant shareholders. These protective measures are discussed in turn below.

(a) Solvency and liquidity test

The first inherent shareholder protective measure is the solvency and liquidity test, which, in essence, is a financial control mechanism as it aims to prevent companies from trading recklessly and/or to the detriment of their shareholders. The test demands that, considering all reasonable foreseeable financial circumstances, the relevant company be solvent (ie the assets of the company, as fairly valued, must equal or exceed the liabilities of the company, also as fairly valued) and liquid (ie the company must be able to pay its debts as it becomes due in the ordinary course of business for a period of 12 months after the date on which the test is considered) at the time of executing the proposed transaction.⁷⁷

In the context of amalgamations or mergers, the board of directors of each constituent company must consider whether, upon implementation of the amalgamation or merger agreement, each proposed amalgamated or merged company⁷⁸ will satisfy the solvency and liquidity test. Only if this inquiry is met with an affirmative answer, may the board of each company submit the amalgamation or merger agreement to its shareholders for their consideration.⁷⁹

(b) Shareholder voting requirements

The shareholder voting requirements is the second intrinsic protective measure. Section 115(1) of the Act provides, inter alia, that despite the provisions of s 65 of the Act, or any provision of a company's Memorandum of Incorporation, or any company resolution to the contrary, a company may not proceed to implement an amalgamation or merger between itself and another company unless the transaction has been approved by the prescribed majority of shareholders of each constituent company. Furthermore, s 115(2)(a) of the Act stipulates that an amalgamation or merger must be approved:

⁷⁷ Section 4(1) of the Act.

⁷⁸ The phrase 'amalgamated or merged company' is defined in s 1 of the Act as meaning: '[A] company that either (a) was incorporated pursuant to an amalgamation or merger agreement; or (b) was an amalgamating or merging company and continued in existence after the implementation of the amalgamation or merger agreement'.

⁷⁹ Section 113(1) read with s 113(4) of the Act.

[B]y a special resolution adopted by persons entitled to exercise voting rights on such a matter, at a meeting called for that purpose and at which sufficient persons are present to exercise, in aggregate, at least 25 [per cent] of all of the voting rights that are entitled to be exercised on that matter, or any higher percentage as may be required by the company's Memorandum of Incorporation, as contemplated in section 64(2).

The above provision denotes that at least 75 per cent of the voting rights that are actually exercised must support the proposal to enter into an amalgamation or merger.⁸⁰ Further to this point, the phrase 'voting rights' is defined in s 1 of the Act as meaning 'the rights of any holder of the company's securities to vote in connection with the matter'. Consequently, a person must be entitled or able to exercise a vote on the matter, failing which he or she or it is excluded from the voting process.

As is further evident from s 115(2)(a) of the Act, as quoted above, it is essential that at least 25 per cent of all the voting rights that can be exercised be present at the relevant shareholders' meeting. The aforementioned statutory requirement in conjunction with the requirement that the transaction must be approved by a special resolution of the shareholders of each constituent company affirms that an amalgamation or merger can be implemented with the support of just 18.75 per cent of a company's total voting rights.⁸¹

Notably, 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 required to pass the required special resolution or for purposes of calculating the necessary quorum.⁸² In so doing, the Act has been commended for providing protection to minority shareholders in

⁸⁰ The phrase 'special resolution' is defined in s 1 of the Act as meaning: [I]n the case of a company, a resolution adopted with the support of at least 75 [per cent] of the voting rights exercised on the resolution...'

⁸¹ To force a higher total voting percentage the company's Memorandum of Incorporation must demand an increased quorum, see Farouk HI Cassim et al op cit note 2 at 690-91. In comparison, s 251(c) of the Delaware General Corporation Law requires that the merger or consolidation be approved by 'a majority of the outstanding stock of the corporation entitled to vote thereon', hence, a merger or consolidation can only be effected with the approval of 50 per cent of the shareholders whose shares carry voting power. Furthermore, under the Model Business Corporation Act 1984, as amended, the transaction must be approved by 25 per cent of the total voting rights, see s 11.04(e) of the aforementioned statute.

⁸² Section 115(4) of the Act.

situations where the acquirer stands on both sides of the transaction,⁸³ although, as will be explained later,⁸⁴ it seems as if s 115(4) of the Act has one further and unintended consequence.

(c) Court approval

As already mentioned in passing, court approval is neither a general nor an automatic requirement for an amalgamation or merger. Indeed, court approval is necessary only if (i) the resolution pertaining to the amalgamation or merger agreement ('the resolution') was opposed by at least 15 per cent of the voting rights that were exercised and, within five business days of the vote, any person who voted against the resolution requires the company to obtain court approval; or (ii) within 10 business days of the vote, the court, on application by a dissenting shareholder, grants that person leave to apply to court for a review of the transaction.⁸⁵

In the event of (i) above, the company must either apply to court for approval of the resolution and bear the costs of such an application, or treat the resolution as a nullity.⁸⁶ The court may in either event set aside the resolution if, in the opinion of the court, (i) the resolution is manifestly unfair to any class of shareholders of a constituent company; or (ii) the vote was materially tainted by a conflict of interest, inadequate disclosure, a failure to comply with the Act or the company's Memorandum of Incorporation or its rules, or any other significant and procedural irregularity.⁸⁷

Importantly, a shareholder can rely on the provisions pertaining to court approval or review only if he or she or it took the positive step of voting against the resolution.⁸⁸ If a shareholder abstained from voting, or if a person (whether he or she or it is a shareholder or not) is ineligible to vote for whatsoever reason, the shareholder or

⁸³ For example, if the acquirer is also a shareholder of the target company, then the acquirer cannot partake in the target company's voting process. See, for example, Ezra Davids et al op cit note 57 at 357; Farouk HI Cassim et al op cit note 2 at 692-93.

⁸⁴ See Chapter 5 below.

⁸⁵ Section 115(3) of the Act. The court will grant leave for a review of the transaction only if it is satisfied that the applicant is acting in good faith, appears to be prepared and able to sustain the proceedings and has made out a prima facie case, see s 115(6) of the Act.

⁸⁶ Section 115(5) of the Act.

⁸⁷ Section 115(7) of the Act.

⁸⁸ Section 115(3) of the Act.

person, as the case may be, is not entitled to seek court approval in terms of s 115(3)-(6) of the Act.⁸⁹

(d) Shareholder appraisal rights

The final and most important inherent protective measure is the appraisal rights of dissenting shareholders.⁹⁰ In the context of amalgamations or mergers, this right is confirmed through s 115(8) of the Act, which stipulates that:

The holder of any voting rights in a company is entitled to seek relief in terms of section 164 if that person –

- (a) notified the company in advance of the intention to oppose a special resolution contemplated in this section; and
- (b) was present at the meeting and voted against that special resolution.

The appraisal remedy is without doubt a less drastic method than contending the validity of the transaction. It represents a sensible method for affording the majority shareholders an opportunity to alter the constitution of the company, whilst protecting the financial interests of the dissenting minority shareholders. But as will be explained in greater detail in Chapter 3.4 and Chapter 3.5 below, in a triangular merger the shareholders of one of the substantive parties to the transaction are deprived of the above inherent protective measures, including the right to opt out of the company by withdrawing the fair value of their shares in cash.⁹¹

3.4 Merger consideration

Section 113(2) of the Act dictates that the constituent companies must enter into a written agreement stipulating the terms and processes of effecting the merger, including, *inter alia*, the consideration payable to the shareholders of the target or disappearing company in exchange for their shares. Crucially, the statutory provisions pertaining to the different forms of merger consideration are broadly

⁸⁹ The position can be compared to lodging a complaint with the relevant statutory body, see Chapter 5 below.

⁹⁰ See, for example, Farouk HI Cassim *et al op cit* note 2 at 678 where it is said that: ‘The right [of appraisal] is thus closely linked to the statutory merger. It is now the prime protective measure for shareholders in a statutory merger’.

⁹¹ Since a triangular merger contemplates the transfer of assets and liabilities from the disappearing company to the surviving merged company and the absorption of the former company into the latter, the term ‘merger’ shall henceforth be used as far as possible (see Chapter 3.3.1 above).

drafted, thus countenancing a variety of forms of merger consideration.⁹² In this regard, s 113(2)(c)-(e) stipulates that the written agreement must specify:

- (c) the manner in which the securities of each amalgamating or merging company are to be converted into securities of any proposed amalgamated or merged company, or exchanged for other property;
- (d) if any securities of any of the amalgamating or merging companies are not to be converted into securities of any proposed amalgamated or merged company, the consideration that the holders of those securities are to receive in addition to or instead of securities of any proposed amalgamated or merged company;
- (e) the manner of payment of any consideration instead of the issue of fractional securities of an amalgamated or merged company or of any other juristic person the securities of which are to be received in the amalgamation or merger.

Hence the merger consideration can take the form of (i) shares in the surviving merged company, which is the more traditional form of merger consideration; (ii) any other property, including cash; or (iii) shares in another company. It is also possible to compensate the shareholders of the disappearing company by making use of a combination of the aforementioned types of merger consideration.⁹³ Therefore, even though the Act is prescriptive with regard to what must be included in the merger agreement, it places very little limitation on the substance of the agreement, including the type of merger consideration payable.⁹⁴

The different types of merger consideration yield a variety of merger structures,⁹⁵ each with its own advantages. Significantly, as the merger consideration can take the form of property other than or instead of shares in the surviving merged company,

⁹² See, for example, Ezra Davids et al op cit note 57 at 344-45; Farouk HI Cassim et al op cit note 2 at 702.

⁹³ Farouk HI Cassim et al op cit note 2 at 687. Likewise, the Delaware General Corporation Law allows for the merger consideration to take the form of 'cash, property, rights or securities of any other corporation or entity in addition to or in lieu of shares or other securities of the surviving or resulting corporation...', see s 251(b) of the aforementioned statute. See also s 11.02(c)(3) of the Model Business Corporation Act.

⁹⁴ Ezra Davids et al op cit note 57 at 344.

⁹⁵ Such as cash mergers, freeze-out mergers, forward triangular mergers and reverse triangular mergers, see Farouk HI Cassim et al op cit note 2 at 702.

the Act seemingly sanctions the use of the triangular merger structures as an acceptable technique for effecting business combinations.⁹⁶

3.5 The triangular merger structures

As the name implies, a triangular merger comprises three participating companies, two of which operate on the acquiring side of the transaction, whereas the remaining company operates on the target side of the transaction. The companies on the acquiring side of the transaction stand in a holding/subsidiary relationship with one another, hence the one company may be referred to as the holding company ('CoH') and the other company as the subsidiary company ('CoS'). The solitary company on the target side of the transaction may simply be referred to as the target company ('CoT').

In a triangular merger CoH is not an official party to the transaction. Instead, the merger is concluded – at least in form – by and between CoT and CoS. CoS is invariably a *newly incorporated* and *wholly owned shell company* of CoH, and is formed by CoH for the *exclusive purpose* of effecting a merger with CoT. Therefore, viewed in isolation, CoS is nothing more than an acquisition vehicle for and on behalf of CoH, the true would-be acquirer.⁹⁷ Also, as CoH is able to distance itself from the transaction (at least superficially), its shareholders are excluded from the voting process and thus unable to rely on any of the inherent shareholder protective measures.

3.5.1 The forward triangular merger structure

In a forward triangular merger CoT merges into CoS. Accordingly, CoS will take transfer of all of the assets and liabilities of CoT and continue in existence as the surviving merged company and wholly owned subsidiary of CoH; whereas CoT will adopt the role of the disappearing company and thus be dissolved by operation of law. This construction enables CoH to bring the business and operations of CoT into its corporate group, albeit under the title of a newly incorporated company.

⁹⁶ Similar provisions (see footnote 94 above) also permit the use of the triangular merger structures in the US, see also, for example, Gilson & Black op cit note 8 at 668. The conclusion that the Act sanctions the use of the triangular merger structures is supported by South African scholars, commentators and practitioners, see Maleka Femida Cassim op cit note 2 at 26; Ezra Davids et al op cit note 57 at 344; Farouk HI Cassim et al op cit note 2 at 702.

⁹⁷ See, for example, *ibid* note 2 at 703.

To implement the merger between CoS and CoT, the shareholders of CoS and CoT must vote in favour thereof. Viewed from the perspective of CoS, the approval process is an uncontentious matter since its shares are held exclusively by CoH, whose board of directors are authorised to vote the shares on its behalf,⁹⁸ and who will do so predictably in favour of the proposed merger.⁹⁹

As consideration for their shares, the shareholders of CoT will receive either cash originating from CoH or shares in the same – not from the recognised acquiring party, CoS.¹⁰⁰ In order to accomplish the this, CoH will usually capitalise CoS with the necessary merger consideration prior to the transaction.¹⁰¹ In this regard, s 48(2)(b) the Act prohibits a subsidiary company from acquiring more than 10 per cent, in aggregate, of the entire issued share capital of its holding company – thus limiting the proportion of merger consideration payable in shares to 10 per cent of CoH's issued shares. To circumvent this issue it can be argued, however, that CoH is entitled to issue its shares directly to the shareholders of CoT, thus avoiding the aforesaid effect of s 48(2)(b) of the Act.¹⁰²

A further limitation on the use of CoH's shares as the exclusive form of merger consideration can be found in s 41(3) of the Act, which requires that an issue of shares be approved by special resolution of the shareholders of any particular class of shares if the voting power of the class of shares to be issued or issuable due to the proposed transaction or series of transactions (ie the merger) will be equal to or exceed 30 per cent of the total voting power of the existing class or classes of shares. Yet this problem can also be avoided by the payment of at least some of the merger consideration in cash and/or by issuing shares devoid of voting power.

⁹⁸ Section 66(1) of the Act stipulates that: 'The business and affairs of a company must be managed by or under the direction of its board, which has the authority to exercise all of the powers and perform any of the functions of the company....'

⁹⁹ See, for example, Cox & Hazen op cit note 44 at 613.

¹⁰⁰ Ibid at 668. In comparison, under a standard two-party merger the acquiring company will pay the merger consideration, whether it be shares in or cash advanced by the acquiring party, to the shareholders of the target company. Thus the ultimate acquirer of control (and recognised constituent party) will be liable for the merger consideration.

¹⁰¹ Ibid at 613.

¹⁰² Maleka Femida Cassim op cit note 2 at 29. In Canada companies are faced with a similar problem in that a subsidiary is prohibited from owning shares in its holding company (see s 30(1) of the Canada Business Corporations Act); but, as is potentially the case in South Africa, the problem can be avoided if the holding company issues its shares directly to the recipients of the merger consideration (ie the shareholders of CoT), see Buckley et al op cit note 37 at 1001.

3.5.2 The reverse triangular merger structure

In a reverse triangular merger CoS is merged into CoT. As a result, CoT will take transfer of all of the assets and liabilities of CoS and continue as the surviving merged company and wholly owned subsidiary of CoH; whilst CoS will adopt the role of the disappearing company and be dissolved by operation of law. As is the case under the forward triangular merger, even though the transaction must be authorised by the shareholders of CoS and CoT respectively, the merger consideration is payable in the form of cash originating from or shares in CoH.

The outcome of a reverse triangular merger may appear ‘paradoxical’ since (i) the shareholders of CoT, ie the surviving merged company, are the recipients of the merger consideration, and (ii) the target company (CoT), as opposed to the acquiring company (CoS), assumes the role of the surviving merged company.¹⁰³ The latter result is particularly useful – and is a distinct advantage of the reverse triangular merger structure – if the intention is to preserve the corporate personality of CoT and/or important contracts concluded in the name of CoT.¹⁰⁴

3.6 Shared advantages of the triangular merger structures

If utilised correctly, the triangular merger structures can provide companies with four notable advantages.¹⁰⁵ It is important to recognise that not all of these advantages are motivated by the desire to circumvent the voting and appraisal rights of shareholders, as is evident from the discussion below. Although this dissertation is intended to highlight the use of the triangular merger structures as a means to circumvent shareholder rights, the facts of every matter remain of utmost importance (hence, the hypothetical scenarios in Chapters 4 and 5 below).

3.6.1 Tax benefits

The potential tax benefits are a real motivating factor for companies. Since triangular mergers can be used for, and classified as, corporate reorganisations – also referred to as corporate restructurings – any financial loss suffered by and recorded in the books of the disappearing company can be carried over or referred to the surviving

¹⁰³ Farouk HI Cassim et al op cit note 2 at 708.

¹⁰⁴ For example, contracts that by their very nature or express terms preclude an automatic transfer of rights and obligations may be kept in place due to the continued existence of the original contracting party, CoT. See, for example, *ibid* at 708; Cox & Hazen op cit note 44 at 614.

¹⁰⁵ To explain these advantages, the acronyms relied on in Chapter 3.5 above is again made use of.

company. In this manner companies are able to reorganise their existing corporate structure whilst benefitting from favourable tax laws, provided the merger consideration is not in the form of cash.¹⁰⁶

3.6.2 Ring-fencing

The transfer of assets from the target company to the acquiring company by operation of law is perhaps the main advantage of the new statutory merger. The concurrent transfer of liabilities, however, can be perilous. For instance, under a standard two-party merger the surviving merged company must take transfer of all of the liabilities of the disappearing company since there are only two companies involved in the transaction.¹⁰⁷ In contrast, the triangular merger structures allow CoH to acquire and conduct the business of CoT in a wholly owned shell subsidiary company, thereby allowing for the liabilities of CoT to be transferred to CoS, as opposed to CoH. In this manner CoH is effectively able to isolate (or ring-fence) the liabilities of CoT – including all unknown and contingent liabilities – in a separate legal entity, CoS.¹⁰⁸ From a business perspective this makes absolute sense. By interposing a corporate veil between itself (CoH) and the target company (CoT), the usual risk of acquiring full ownership of another corporation is greatly abated, something that can be a major advantage when the target company is a high-risk or unrelated business enterprise.¹⁰⁹

3.6.3 Continued existence

Another disadvantage of the two-party merger structure is that at least one of the constituent companies must disappear subsequent to the transaction – which can be an undesired outcome if both companies are commercially valuable assets.

In accordance with the triangular merger structures, however, neither CoH nor CoT (or, at least, the business of CoT) need disappear as a consequence of the merger. As explained above,¹¹⁰ the result of a forward triangular merger is that CoT is merged into CoS, thus allowing CoH to maintain the business operations of CoT; whereas the outcome of a reverse triangular merger is that CoS is merged into CoT,

¹⁰⁶ Clarke op cit note 31 at 430-31. For the tax consequences under South African law, see ss 42-47 and s 103 of the Income Tax Act 58 of 1962.

¹⁰⁷ Gilson & Black op cit note 8 at 669.

¹⁰⁸ See, for example, Cox & Hazen op cit note 44 at 612; Farouk HI Cassim et al op cit note 2 at 705.

¹⁰⁹ Cox & Hazen op cit note 44 at 612.

¹¹⁰ See Chapters 3.5.2 and 3.5.3 above.

therefore allowing CoT to remain in existence as a wholly owned subsidiary company of CoH. Since CoT is integrated into CoS, or vice versa, the business, customer relationships, goodwill and workforce of CoT is maintained substantially intact and unchanged.¹¹¹

3.6.4 Avoiding voting and appraisal rights

In a traditional two-party merger the shareholders of both constituent companies are afforded voting and appraisal rights. The obligation to submit the merger agreement for voting purposes and the inevitable cash drain resulting from the exercise of appraisal rights is, however, an unwelcome prospect for many companies wanting to arrange a merger.¹¹² The triangular merger structures allow CoH to avoid the foregoing, since, strictly speaking, a triangular merger is effected by and between CoS and CoT. Consequently, CoH's board of directors is not obliged to submit the amalgamation or merger agreement to its shareholders for a vote and therefore its shareholders cannot withdraw from the company by way of their (usual) appraisal rights.¹¹³ This is a vitally important advantage of the triangular merger structures and a strong practical reason for making use thereof.¹¹⁴

3.7 Substance versus form

It is indeed correct to deem CoH as a substantive party to the merger since it is CoH that identifies the target company (CoT), causes one of the constituent companies (CoS) to be incorporated, and provides the merger consideration.¹¹⁵ Furthermore, the transaction has a definite impact on the shareholders of CoH. If the merger consideration is paid in the form of newly issued shares in CoH, the increase in the number of shares will cause a dilution of the proportionate shareholding of the existing shareholders and/or may result in a decrease of CoH's current share value. Alternatively, if the consideration is paid in cash, the source of those funds is either direct shareholder investments and/or is generated from initial shareholder investments. Yet

¹¹¹ Farouk HI Cassim et al op cit note 2 at 705; Cox & Hazen op cit note 44 at 612.

¹¹² See Chapter 2.3.2(a) above.

¹¹³ As noted in Chapters 2.4 and 3.3.2(d) above, voting and appraisal rights are closely associated. Thus in order to successfully exercise the right of appraisal, a shareholder must have voted against the resolution that gave rise to his or her or its discontent. See also, for example, Gilson & Black op cit note 8 at 669.

¹¹⁴ See, for example, Farouk HI Cassim et al op cit note 2 at 705-06; Ezra Davids et al op cit note 57 at 344.

¹¹⁵ Farouk HI Cassim et al op cit note 2 at 706; Gilson & Black op cit note 8 at 669.

irrespective of CoH's involvement and the impact of the transaction on its shareholders, it is the structure of the transaction that currently determines the availability of shareholder rights.

The present exclusion of CoH's shareholders from the voting (and thus the appraisal) process can be contrasted with the initial position adopted in the draft Bill. In terms of the draft Bill, the shareholders of CoH had to approve the merger between CoH's wholly owned subsidiary company (CoS) and the target company (CoT). Therefore, as the shareholders of CoH had the right to vote, they could also exercise their right of appraisal.¹¹⁶ By including the shareholders of CoH in the voting process – and so affording them appraisal rights – the draft Bill promoted the belief that the substance (ie the cause and effect) of a transaction should be the ultimate determining factor in awarding shareholder rights. Notably, the draft Bill was lauded for emphasising the substance as opposed to the form of the transaction.¹¹⁷ What is more, subsequent to the decision to deviate from the position adopted in the draft Bill, the Act has come under strong criticism:

The exclusion of this protective requirement [ie the right of CoH's shareholders to vote and approve by special resolution the merger between its wholly owned subsidiary company, CoS, and CoT] is unfortunate and may have substantial practical ramifications, in that the failure to give voting and appraisal rights to the shareholders of [CoH] in a triangular merger *creates a distinct potential for unfairness to the shareholders of [CoH]*.¹¹⁸

The refusal of shareholder voting and appraisal rights in the context of triangular mergers is distorted by the fact that a disposal of all or the greater part of a subsidiary company's assets ('a disposal') – which is also one of the other recognised fundamental transactions – triggers the voting and appraisal rights of the holding company's shareholders.¹¹⁹ The decision to award voting and appraisal rights when implementing a disposal but not when undertaking a triangular merger thus seems arbitrary, especially considering the fundamental corporate change resulting from

¹¹⁶ Clause 119(2)(b) and (7) of the draft Bill; Maleka Femida Cassim op cit note 2 at 31.

¹¹⁷ Maleka Femida Cassim ibid.

¹¹⁸ Farouk HI Cassim et al op cit note 2 at 706.

¹¹⁹ A disposal must be approved by the shareholders of the holding company if it constitutes a disposal of all or the greater part of the assets or undertaking of the holding company (for example, if the subsidiary company holds the majority of the assets or conducts the main and/or more profitable business), see s 115(2)(b) of the Act. Although a disposal may potentially have a greater impact on the holding company, both types of transactions (ie a disposal and a merger) nevertheless envision an innate change to the rights and expectations of existing shareholders.

both types of transactions and the development of the appraisal remedy as a protagonist to corporate change and its function as a ‘safety valve through which dissenters’ unhappiness can be ventilated without interrupting the acquisition’.¹²⁰

As a final point, it is worth noting that the idea of affording voting rights to the shareholders of CoH is not unknown. For instance, the California Corporations Code stipulates that a merger must be approved by the shareholders of a company ‘in control of any constituent or acquiring domestic or foreign corporation or other business entity...and whose equity securities are issued, transferred, or exchanged in the reorganization...’.¹²¹ By adopting a similar provision, the Act would go a long way in ensuring that the triangular merger structures are not abused by unscrupulous companies.

3.8 Conclusion

A vital purpose of the inherent shareholder protective measures, particularly the voting requirements and the right to opt out of the company, is to ensure that fundamental corporate change cannot be implemented by management alone. As it stands, however, the Act seemingly allows companies to undermine the voting and appraisal rights of their shareholders. Whether this was an intended purpose is unclear. Why incorporate a remedy designed to offset the effects of majority rule, yet permit the use of the triangular merger structures as a means to circumvent those very same rights? Why ignore the practical effects of a triangular merger? If the intention was to allow companies to make use of the triangular merger structures so as to deprive their shareholders of their voting and appraisal rights, then the legislator should have stipulated so unequivocally. As has rightly been observed:

Even where a statute does not deal with the problem explicitly, it can be argued that the triangular merger triggers voting and appraisal rights in [CoH’s] shareholders on the theory that [CoH] should be deemed to be a constituent to the merger, or alternatively that such a result is necessary to prevent subversion of the merger statutes.¹²²

¹²⁰ Cox & Hazen op cit note 44 at 620. It is uncertain whether the legislator’s decision to award voting and appraisal rights to the holding company’s shareholders during a disposal was influenced by the development of the de facto merger doctrine as applied in the US, see Chapter 6 below.

¹²¹ Sections 1200(d) and 1201(f) of the California Corporations Code, 1947, as amended.

¹²² William L Cary & Melvin Aron Eisenberg *Cases and Materials on Corporations* 5 ed (1980) 1500.

A possible solution – and this is in essence what the draft Bill proposed – is to allow for the rights that are settled in the holding company to pass through to the individual shareholders of the said company. In so doing, the right to vote and thus the right to opt out of the company will be taken away from the holding company’s board of directors, so to speak, and instead settle in the shareholders of the holding company, who will be entitled to vote on the matter in their personal capacity. Any potential recalcitrant minority shareholder will thus be enabled to opt out of the company by withdrawing the fair value of his or her or its shares. Such an approach, it is submitted, not only seems fair considering the substance of the triangular mergers, but will also preserve the integrity of the right of appraisal.¹²³

PART B:

SHAREHOLDER REMEDIES

Option 1: Application for an order to disregard the separate legal identity of the acquisition vehicle

4. DISREGARDING THE CORPORATE CHARACTER

4.1 Introduction

The principle that a lawfully incorporated company is a legal persona completely separate and distinct from its individual members was established by the House of Lords in *Salomon v Salomon & Co Ltd*.¹²⁴ In the words of Lord Macnaghten:

The company is at law a different person altogether from the subscribers...and, though it may be that after incorporation the business is precisely the same as it was before, the same persons are managers, and the same hands receive the profits, the company is not in law the agent of the subscribers or trustee for them. Nor are the subscribers as members liable, in any shape or form, except to the extent and in the manner provided by [law].¹²⁵

The rule enunciated in *Salomon* (‘the *Salomon* rule’) is affirmed in section 19(1) of the Act, which provides that from the moment that a company’s incorporation is

¹²³ See Eisenberg op cit note 18 at 284-94 for a detailed discussion on the idea that the right should and can be passed onto the shareholders of the holding company. Note, however, that Eisenberg formulates his argument with reference to a sale of substantially all of a company’s assets.

¹²⁴ [1895-1899] All ER Rep 33 (HL).

¹²⁵ At 48.

recorded in the central register for companies, as stated in the company's registration certificate, until the removal thereof from the aforesaid register, a company is endowed with all of the legal powers and the capacity of a natural person, except to the extent that the particular company is incapable of exercising such power or capacity or is otherwise limited by way of its Memorandum of Incorporation.

The effect of the *Salomon* rule is that the law interposes another person (that is, the company), real though artificial, between the shareholders of the company and third parties dealing with the company.¹²⁶ In other words, and to use a metaphor which is often applied, once a company is incorporated, a veil or curtain is drawn between the company, on the one hand, and its shareholders and directors, on the other. This not only distinguishes the aforesaid parties from one another but also ensures that the shareholders and the directors cannot be held liable for the debts, liabilities or actions of the company.¹²⁷

The *Salomon* rule is an important cornerstone of company law and thus generally applied by South African courts.¹²⁸ The rule is not, however, absolute. In certain instances a court of law will 'pierce' or 'lift' or 'draw aside' the veil of incorporation in order to look behind the façade of the corporate persona.¹²⁹

4.2 Piercing or lifting the corporate veil

Since a company's separate legal identity is a figment of law, it is capable of being set aside by a court whenever the corporate form is being 'abused' or 'thwarted' in a manner that is contrary to the foundation of the legal fiction.¹³⁰ Notably, by disregarding the corporate personality, it is possible to assign liability elsewhere for what are ostensibly the acts of the company.¹³¹

The disregard of the corporate persona is often referred to as 'piercing' or 'lifting' the corporate veil. In *Atlas Maritime Co SA v Avalon Maritime Ltd, The Coral Rose*

¹²⁶ *Gas Lighting Improvements Co Ltd v Inland Revenue Commissioner* 1923 AC 723 (HL) at 741.

¹²⁷ Farouk HI Cassim et al op cit note 2 at 41.

¹²⁸ See, for example, *Dadoo Ltd v Krugersdorp Municipal Council* 1920 AD 530; *The Shipping Corporation of India Ltd v Evdomon Corporation* 1994 (1) SA 550 (A).

¹²⁹ *Airport Cold Storage (Pty) Ltd v Ebrahim* 2008 (2) 303 (C) at 306. See also Cilliers et al op cit note 59 at 13.

¹³⁰ See, for example, *Ebrahim v Airport Cold Storage (Pty) Ltd* 2008 (6) SA 585 (SCA) para 15: '[I]t is an apposite truism that close corporations and companies are imbued with identity only by virtue of statute. In this sense their separate existence remains a figment of law, liable to be curtailed or withdrawn when the objects of their creation are abused or thwarted'.

¹³¹ *Cape Pacific v Lubner Controlling Investments (Pty) Ltd* 1995 (4) SA 790 (A) at 802.

(*No 1*)¹³² Staughton LJ explained the difference between the aforementioned sayings as follows:

To pierce the corporate veil is an expression that I would reserve for treating the rights or liabilities or activities of a company as the rights or liabilities or activities of its shareholders. To lift the corporate veil or look behind it, on the other hand, should mean to have regard to the shareholding in a company for some legal purpose.¹³³

Despite the subtle nuances in terminology (which has often resulted in unnecessary confusion) the end result is the same: by piercing or lifting the corporate veil the focus will shift from the company as an independent legal person to the persons (whether natural or legal) behind it or in control thereof.¹³⁴ For present purposes it is the shareholding in the subsidiary company that is of importance, hence the phrase ‘lifting the corporate veil’ is the more appropriate and shall as far as possible be used herein.

It is clear from a consideration of legal authorities that a court will not easily disregard the principle that a company is a person altogether separate and distinct from its individual members.¹³⁵ Indeed, under South Africa’s common law, a ‘judicial philosophy’ emerged that piercing or lifting the corporate veil is an extraordinary remedy that will be reverted to only in special or exceptional circumstances and as a last resort.¹³⁶ Yet given the stout reluctance to adopt a categorising approach,¹³⁷ precisely what will constitute ‘special’ or ‘exceptional’ circumstances is unclear. As noted by Rogers AJA in *Briggs v James Hardie & Co (Pty) Ltd*,¹³⁸ a case referred to by Dlodlo J in *Amlin (Pty) Ltd v Van Kooij*:¹³⁹

[T]here is no common, unifying principle, which underlies the occasional decision of the courts to pierce the corporate veil. Although an ad hoc explanation

¹³² [1991] 4 All ER 796 (CA).

¹³³ At 779.

¹³⁴ *Cape Pacific* supra note 131 at 802.

¹³⁵ See, for example, *ibid* at 803; *Hülse-Reutter v Gödde* 2001 (4) SA 1336 (SCA) para 20: ‘There can be no doubt that the separate personality of a company is to be recognised and upheld except in the most unusual circumstances’.

¹³⁶ *Ex Parte Gore* 2013 (3) SA 382 (WCC) para 27.

¹³⁷ See, for example, *The Shipping Corporation of India* supra note 128 at 566; *Cape Pacific* supra note 131 at 802-03.

¹³⁸ (1989) 16 NSWLR 549 (NSWCA).

¹³⁹ 2008 (2) SA 558 (C) at 565.

may be offered by a court which so decides, there is no principled approach to be derived from the authorities.¹⁴⁰

Likewise, in the most recent of a long list of English decisions on the subject, the United Kingdom Supreme Court remarked that:

The notion that there is no principled basis upon which it can be said that one can pierce the veil of incorporation receives some support from the fact that the precise nature, basis and meaning of the principle are all somewhat obscure, as are the precise nature of circumstances in which the principle can apply.¹⁴¹

Hence the law is far from settled. Instead, each case involves an inquiry into the particular facts ‘which, once determined, may be of decisive importance’.¹⁴² As is apparent from existing case law, it has, however, long been recognised that the presence of fraud, dishonesty or other improper conduct will validate a decision to disregard the corporate persona; such behaviour is a marker or touchstone for the courts. Indeed, in *Salomon* – the very basis for the notion that a company is endowed with a personality of its own – their Lordships were at pains to point out that, based on the facts, it was not the intention of the company’s members to use the distinct personality of the particular company in question to perpetrate a fraud on others.¹⁴³ Similarly, in *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd*¹⁴⁴ Smalberger JA said that:

It is undoubtedly a salutary principle that our Courts should not lightly disregard a company’s separate personality, but should strive to give effect to and uphold it...But where fraud, dishonesty or other improper conduct...is found to be present, other considerations will come into play.¹⁴⁵

South Africa’s courts will adopt a balancing approach when determining whether or not to lift the corporate veil. This means that the need to preserve the separate legal personality of the relevant company must be weighed against policy considerations in favour of lifting the veil of incorporation (such as the presence of fraud, dishonesty or other improper conduct).¹⁴⁶ In making the aforesaid determination, a court

¹⁴⁰ *Briggs* supra note 138 at 567.

¹⁴¹ *VTB Capital Plc v Nutritek International Corp* [2013] UKSC 5 para 123.

¹⁴² *Cape Pacific* supra note 131 at 802. See also, for example, *Hülse-Reutter* supra note 135 at 1346.

¹⁴³ *Salomon* supra note 124 at 35, 37, 39, 40, 42, 46, 49 and 51.

¹⁴⁴ Supra note 131.

¹⁴⁵ At 803.

¹⁴⁶ *Ibid.*

may consider the substance rather than the form of the transaction or series of transactions in question. As remarked by Innes CJ in *Dadoo Ltd v Krugersdorp Municipal Council*:¹⁴⁷

[T]he rule [that a court may lift the corporate veil and disregard the separate legal personality of a company] is merely a branch of the fundamental doctrine that the law regards the substance rather than the form of things – a doctrine common, one would think, to every system of jurisprudence and conveniently expressed in the maxim *plus valet quod agitur quam quod simulate concipitur*.¹⁴⁸

It is not necessary for a company to have been founded in deceit. A company that is misused in a particular instance, whether to commit a fraud or some other kind of dishonest conduct, will be deemed not to be a separate legal entity for that specific action; for all other purposes it will be recognised as a separate juristic person with rights and obligations of its own.¹⁴⁹

4.3 Statutory codification

For the first time in South African company law a statutory provision exists that sanctions a court to disregard the separate legal personality of a company. The relevant provision reads as follows:

If, on application by an interested person or in any proceedings in which a company is involved, a court finds that the incorporation of the company, any use of the company, or any act by or on behalf of the company, constitutes an unconscionable abuse of the juristic personality of the company as a separate entity, the court may –

- (a) declare that the company is to be deemed not to be a juristic person in respect of any right, obligation or liability of the company or of a shareholder of the company or, in the case of a non-profit company, a member of the company, or of another person specified in the declaration; and
- (b) make any further order the court considers appropriate to give effect to a declaration contemplated in paragraph (a).¹⁵⁰

¹⁴⁷ *Dadoo* supra note 128.

¹⁴⁸ At 547.

¹⁴⁹ See, for example, *Cape Pacific* supra note 131 at 804.

¹⁵⁰ Section 20(9) of the Act.

Although the statutory codification of the doctrine was welcomed, certain aspects remained unclear. For example, what is the meaning of ‘unconscionable abuse’? Is the remedy still one that can only be applied in exceptional circumstances and as a last resort; who will qualify as an interested person; and does the statutory provision supersede the common law principles regarding lifting the corporate veil?¹⁵¹ Fortunately, these questions have all been addressed by Binns-Ward J in *Ex Parte Gore*,¹⁵² the first judgment pertaining to section 20(9) of the Act.

4.3.1 The *Ex Parte Gore* decision

The applicants were the liquidators of 41 different companies which together formed a group of companies known as ‘the King Group’. The ultimate holding company, King Financial Holdings (‘KFH’), was also in liquidation. At all times relevant to the proceedings, the three King brothers retained the majority of shares in KFH – thereby allowing them to exercise complete control over the subsidiary companies in the King Group – and were the directors of KFH and most of the other companies comprising the King Group.

The companies in the King Group provided financial services by way of marketing investments in commercial and residential immovable properties. In general, investments solicited by the King Group were structured in the form of a purchase by the would-be investor of shares in one of the companies in the group. The purchase of shares was coupled with an extension of a loan by the investor to the company of which he or she or it was expected to become a shareholder.

In time the activities of the King Group attracted the attention of the Financial Services Board (‘FSB’) which, after conducting a search and seizure operation, prepared a damning report that contributed to the ultimate winding-up of the King Group. Thereafter the liquidators of the relevant companies commissioned an investigation by a private firm of accountants. The report confirmed that the affairs of the group were conducted in a manner that maintained no apparent distinction between the companies comprising the group. In fact, the report concluded that the companies in the King Group operated as one entity through their holding company, KFH. The report also spoke to various dishonest and fraudulent practises, for example: (i) funds

¹⁵¹ Rehana Cassim ‘Hiding behind the veil’ (2013) *De Rebus* 34 at 35.

¹⁵² *Supra* note 136.

solicited from investors were transferred by KFH between the various companies constituting the King Group at will, and without regard to the distinct identity of the companies concerned; and (ii) in many cases the documentation purporting to evidence an investment were so ineptly prepared that it did not even identify the company invested in by the shareholders.

As a result of the above, as well as certain other irregular practises highlighted by the court,¹⁵³ the liquidators of the King Group were unable to identify the relevant entities against which individual investors may well have claims, resulting in their application for an order whereby they sought to selectively disregard the separate legal personalities of the subsidiary companies within the group, so as to enable them to treat the residual assets of the subsidiary companies as assets of the holding company, KFH.

The court acknowledged that the abuse of the group structure is one of the known factors that will lead to a decision to lift the corporate veil and to treat the holding or parent company as being liable for the acts of its subsidiary company or companies.¹⁵⁴ The court ultimately held that, considering the total disregard by the King brothers of the separate and distinct legal personalities of each company within the group, as well as their numerous fraudulent dealings, it would be appropriate to lift the corporate veil – in terms of s 20(9) of the Act – with regard to all of the companies within the King Group, except for KFH (the holding company), and therefore to regard the companies within the group as one single entity, namely KFH. As remarked by Binns-Ward J:

It is evident from the [FSB and independent] reports that the disregard by the King brothers for the separate corporate personalities of the companies in the King Group was so extensive as to impel the conclusion that the group was in fact a sham. There was in reality no distinction for practical purposes when it

¹⁵³ The court noted the following practises, some of which overlap with the independent report: (i) the indiscriminate allocation of shareholder investments (see para 12); (ii) the incompetent drafting of shareholder certificates (see para 12); (iii) the flow of shareholder investments was determined by the King brothers in accordance with their need to keep their scheme afloat (see para 12); (iv) shares in KFH were sold to members of the public despite the fact that KFH was not a publicly traded company (see para 13); and (v) share distributions exceeded the number of issued shares (see para 13).

¹⁵⁴ Para 26.

came to dealing with investor's funds, between KFH and the subsidiary companies.¹⁵⁵

4.3.2 Interpreting s 20(9) of the Act

The court in *Ex Parte Gore* provided valuable insight as to the interpretation of s 20(9) of the Act, as well as the impact of the aforementioned section on the common law doctrine of lifting the veil.

(a) The meaning of 'unconscionable abuse'

The phrase 'unconscionable abuse' is not defined in the Act. Furthermore, in keeping with the historic preference not to adopt a categorising approach, the Act does not prescribe the circumstances that will give rise to a decision to lift the corporate veil.

With regard to the potential meaning of 'unconscionable abuse', the court in *Ex Parte Gore* stated that:

The term 'unconscionable abuse of the juristic personality' postulates conduct diverse enough to cover all the descriptive terms like 'sham', 'device', 'stratagem', and the like used in that connection in the earlier cases, and – as the current case illustrates – conceivably much more.¹⁵⁶

Binns-Ward J also went on the remark that s 20(9) of the Act ensures that a remedy can be provided to a person 'whenever the illegitimate use of the concept of juristic personality adversely affects a third party in a way that reasonably should not be countenanced'.¹⁵⁷

The *Ex Parte Gore* decision denotes that future inquiries will continue to be determined with reference to the facts of every case, and that the courts will continue to balance the need to preserve the separate legal personality of a company with those facts in favour of doing otherwise. Furthermore, the use of the word 'reasonably' (see para 34) indicates the approval of an objective standard, which would suggest that the courts have a wide discretion whether or not to lift the veil of incorporation. Although this approach largely resonates with the common law principles, it also means that it remains somewhat unclear as to when the corporate persona will be disregarded.

¹⁵⁵ Para 15.

¹⁵⁶ Para 34.

¹⁵⁷ Ibid.

(b) The triggers of s 20(9)

As noted above,¹⁵⁸ under the common law lifting the corporate veil was perceived as an ‘exceptional’ or ‘drastic’ remedy that could only be invoked as a last resort. In *Ex Parte Gore*, however, Binns-Ward J rejected this outlook. The court held that by allowing a person to rely on the remedy simply when the facts of a particular case justify it, the statutory provision detracts from the idea that the remedy should be regarded as ‘exceptional’ or ‘drastic’,¹⁵⁹ and that due to the unqualified availability of the remedy, s 20(9) of the Act ‘militates against an approach that it should be granted only in the absence of an alternative remedy’.¹⁶⁰

The following extract concisely articulates the court’s reasoning with regard to the application of s 20(9) of the Act and is indicative of a more relaxed approach to lifting the veil, provided, of course, the facts justify such a decision:

The newly introduced statutory provision affords a firm, albeit very flexibly defined, basis for the remedy, which will inevitably operate, I think, to erode the foundation of the philosophy that piercing [or lifting] the corporate veil should be approached with [a] priori diffidence. By expressly establishing its availability simply when the facts of a case justify it, the provision detracts from the notion that the remedy should be regarded as exceptional, or ‘drastic’.¹⁶¹

(c) Who or what is an ‘interested person’

Although s 20(9) of the Act enables an ‘interested person’ to apply to court for an order in terms of which the separate legal personality of a company is disregarded, the Act fails to define the phrase. Nevertheless, as pointed out by Binns-Ward J, the phrase is in no means shrouded in mystique:

The standing of any person to seek a remedy in terms of the provision should be determined on the basis of well-established principle...and, of course, if the facts happen to implicate a right in the Bill of Rights, s 38 of the Constitution.¹⁶²

In other words, an applicant will be deemed to be an interested person (and thus have locus standi) if he or she or it has a direct and sufficient interest in the relief sought.¹⁶³

¹⁵⁸ See Chapter 4.2 above.

¹⁵⁹ Para 34.

¹⁶⁰ Ibid.

¹⁶¹ Ibid.

¹⁶² Para 35.

(d) The impact of the statutory provision on the common law

Section 20(9) of the Act does not override the common law. As remarked by Binns-Ward J, if s 20(9) of the Act is interpreted with regard to ss 5 and 7 of the Act (which sections relate to the general interpretation and purpose of the Act), then it cannot be said that there exists any discord between the statutory provision and the erstwhile approach to lifting the corporate veil as developed in terms of the common law.¹⁶⁴ The court held that, if anything, the scope of the doctrine appears to have been broadened by the legislator.¹⁶⁵ Also, because s 20(9) of the Act is drafted in broad terms and does not follow a categorising approach, the provision must be construed as being supplemental to the common law, as opposed to substitutive.¹⁶⁶

As s 20(9) of the Act does not override the common law, cases decided prior to the incorporation of s 20(9) of the Act – especially those pertaining to the disregard of the corporate personality in the context of company groups – remain relevant and will thus provide a good indication as to the potential success of using s 20(9) of the Act as a means to challenge the implementation of the triangular merger structures.

4.4 Company Groups

It is a well-known legal principle that each company within a group of companies is a separate legal entity.¹⁶⁷ Consequently, the mere fact that a single person or entity owns the majority or all of the issued share capital of a company does not per se deprive the company of its separate legal existence;¹⁶⁸ although it may be a relevant factor (see the cases discussed in Chapter 4.4.1 below). Nor does the fact that a group of companies constitutes one economic unit justify an overall conclusion that the companies should be regarded as one entity.¹⁶⁹

Companies have taken advantage of the above legal principle by isolating certain activities and/or liabilities in different subsidiary or sub-subsidiary companies. In this manner, holding companies are able to achieve limited liability. This has, in some

¹⁶³ *Jacobs v Waks* 1992 (1) SA 521 (A) at 533-34.

¹⁶⁴ Para 32.

¹⁶⁵ Para 33.

¹⁶⁶ Para 34.

¹⁶⁷ *Harold Holdsworth & Co (Wakefield) Ltd v Caddies* [1955] 1 All ER 725 (HL); *The Albezero* [1975] 3 All ER 21 (CA); *Adams v Cape Industries plc* [1991] 1 All ER (CA); *Ritz Hotel Ltd v Charles of the Ritz* 1988 (3) SA 290 (AD).

¹⁶⁸ See, for example, *Smith, Stone & Knight Ltd v Birmingham Corp* [1939] 4 All ER 116 (KBD).

¹⁶⁹ See, for example, *Adams* supra note 167 at 116.

instances, given rise to undercapitalised subsidiary or sub-subsidiary companies, which is then used for improper purposes.¹⁷⁰

In a number of judgments regarding company groups, however, the courts have disregarded the veil of incorporation and, in so doing, recognised the substance or realities of the situation. As acknowledged in *DHN Food Distributors Ltd v London Borough of Tower Hamlets*,¹⁷¹ there is proof of a ‘general tendency to ignore the separate legal personality of various companies within a group, and to look instead at the group as a whole’,¹⁷² provided the facts validates such a conclusion.

In determining whether or not to disregard the legal personality of a company within a group of companies, the courts will adopt an approach similar to that discussed in Chapter 4.2 above, that is a balancing approach whereby the need to preserve the separate legal personality of the company is weighed against policy considerations in favour of lifting the corporate veil. Also, as is generally the case, it is difficult to define exactly when a court will lift the corporate veil in the context of company groups, although the use of a subsidiary company as a mere cloak or façade to disguise the true facts, or as a device or sham to deceive others, may very well cause a court to reject the distinction between the individual companies comprising a corporate group.¹⁷³ Again, the facts of every case are of overriding importance.

4.4.1 Examples of lifting the corporate veil

In *DHN Food Distributors*¹⁷⁴ the UK Court of Appeal decided (unanimously per Lord Denning MR, Goff LJ and Shaw LJ) to look at the realities of the situation and to pierce the corporate veil. Thus the claimants, the holding company itself, succeeded in having its veil of incorporation lifted so as to claim compensation for the compulsory acquisition by the local authorities of certain premises belonging to and from which the claimant’s wholly owned subsidiary company conducted the business

¹⁷⁰ Andrew Hicks & SH Goo *Cases & Materials on Company Law* 4 ed (2001) 103.

¹⁷¹ [1976] 3 All ER 462 (CA).

¹⁷² At 467, per Lord Denning MR, quoting from Gower *Principles of Modern Company Law* 3 ed (1969) 216.

¹⁷³ See, for example, *Smith v Hancock* [1894] 2 Ch 377; *Jones v Lipman* [1962] 1 All ER 442; John Birds, AJ Boyle, Bryan Clark et al *Boyles & Birds’ Company Law* 8 ed (2011) 59. The notion that a company has acted as the agent of another company will not be applied easily. This is especially so in the absence of an express agreement to the effect, see, for example, Hicks & Goo op cit note 170 at 103. See also *Ex Parte Gore* supra note 136 para 34 where the court remarked that s 20(9) of the Act is wide enough to cover all the descriptive terms used at common law.

¹⁷⁴ Supra note 171.

operations of, so it was held, the claimant. The following extract from the judgment of Lord Denning MR regarding the factual circumstances that will give rise to a ruling to lift the corporate veil echoes the view of the court:

This is especially the case when a parent company owns all of the shares of the subsidiaries, so much so that it can control every movement of the subsidiaries. These subsidiaries are bound hand and foot to the parent company and must do just what the parent company says.¹⁷⁵

In *FG (Films) Ltd*¹⁷⁶ the applicants, the shareholders of a company incorporated in England, sought a declaration that (i) the applicant's company be declared the maker of a film (entitled 'Monsoon') within the meaning of the Cinematography Act 1938; (ii) throughout the filming of the said film the applicant's company was a 'British company' within the meaning of the said statute; and (iii) throughout the filming process the said film was being made by a British company within the meaning of the said statute. In denying the application, the court focused on the shareholding of the applicant company and the source of the funding for the filming process. The court held that since the majority shareholder was a US citizen (a fact that caused the company to be excluded from the scope of the aforementioned statute) and as the company was inadequately capitalised for purposes of financing the film (based on the number of issued shares and their value), it cannot be said that the film or the company qualified as being 'British' under the Cinematography Act. In delivering the court's judgment, Vaisey J remarked as follows:

I now understand that [the applicant's company has] no place of business apart from [its] registered office, and that [the applicant's company] did not employ any staff. It seems to me to be contrary, not only to all sense and reason, but to the proved and admitted facts of the case, to say or to believe that this insignificant company undertook in any real sense of that word the arrangements for the making of this film.¹⁷⁷

Similarly, in *Jones v Lipman*¹⁷⁸ the court held that the first defendant's actions (transferring an immovable property to a shell company owned by him in order to put the property beyond the reach of the plaintiff, who initially bought the said prop-

¹⁷⁵ At 467.

¹⁷⁶ [1953] 1 All ER 615.

¹⁷⁷ At 616.

¹⁷⁸ *Jones* supra note 173.

erty and was claiming specific performance of the contract of sale) constituted an abuse of the corporate form. Russell J remarked that: '[t]he defendant company is the creature of the first defendant, a device and a sham, a mask which he holds before his face in an attempt to avoid recognition by the eye of equity'.¹⁷⁹

In *Wallersteiner v Moir*¹⁸⁰ Lord Denning MR was again amenable to disregarding the separate legal personality of different corporate entities controlled by the same person, a certain Dr Wallersteiner. In delivering his verdict, Lord Denning MR opined as follows:

Even so, I am quite clear that [the companies complained of] were just the puppets of Dr Wallersteiner. He controlled their every movement. Each danced to his bidding. He pulled the strings. No one else got within reach of them...I am of the opinion that the court should pull aside the corporate veil and treat these concerns as being his creatures...At any rate it was up to [Dr Wallersteiner] to show that any one else had a say in their affairs and he never did so...¹⁸¹

Unsurprisingly, the South African judiciary followed suit and promptly disregarded the separate legal personality of a company whenever the facts of the matter warranted such action.¹⁸² In *Ritz Hotel Ltd v Charles of the Ritz Ltd*,¹⁸³ for example, the court referred to various decisions by the UK courts, including *DHN Food Distributors*, and relied thereon as justification for following a more relaxed approach, thus resulting in the court's decision to disregard the legal persona of a company within a group of companies. As remarked by Nicholas AJA:

It is clear that the acts of a holding company are not per se the acts of its wholly owned subsidiary, or vice versa, since the holding company is a separate legal entity from its subsidiary; but in recent years, there has become evident in the English cases a more relaxed approach to the application of this basic principle.¹⁸⁴

¹⁷⁹ At 445.

¹⁸⁰ [1974] 3 All ER 217.

¹⁸¹ At 238.

¹⁸² See, for example, *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168; *R v Gillett* 1929 AD 364; *Gering v Gering* 1974 (3) SA 358 (W). The courts have also disregarded the corporate persona based on section 65 of the Close Corporations Act 69 of 1984, which is worded similarly to section 20(9) of the Act, see, for example, *Ebrahim* supra note 130.

¹⁸³ *Ritz* supra note 167.

¹⁸⁴ At 314. The fact that the South African judiciary adopts a more liberal approach than the courts in the UK was also noted in *Ex Parte Gore* supra note 136 para 27.

In *Cape Pacific Ltd*¹⁸⁵ the Appellate Division overturned the decision by the court a quo¹⁸⁶ and ordered that the corporate persona be disregarded. In brief, the court held that, due to the control exercised by the respondent, the companies in question were nothing more than the respondent in ‘a different guise’ and that the respondent used the companies in question as a ‘device or stratagem’ to avoid specific performance of the contract of sale.¹⁸⁷

4.4.2 Instances where the courts opted not to lift the corporate veil

Following the decision by the UK Court of Appeal in *Adams v Cape Industries plc*,¹⁸⁸ the South African judiciary have traditionally adopted a more restrictive approach – although the facts of the particular cases greatly favoured the results. Referring to *Adams*, the courts in *Wambach v Maizecor Industries (Edms) Bpk*¹⁸⁹ and *Macadamia Finance Bpk v De Wet*¹⁹⁰ refused to disregard the separate legal identity of a company.

In *Wambach* the respondent, the holding company of a wholly owned subsidiary company, instituted an action for damages. The claim stemmed from an accident wherein a vehicle belonging to the wholly owned subsidiary company was damaged. The court a quo allowed the claim, thereby deciding that the holding company had legal standing to institute the action. However, the Appellate Division overturned the decision. It held that an asset that is registered in the name of a wholly owned subsidiary company does not belong to that subsidiary’s holding company, this is so regardless of whether the holding company’s board of directors also acted as the subsidiary’s board, and despite the fact that the holding company could effectively exercise control over the damaged asset.

In *Macadamia Finance Bpk* the question before the court was whether the legal duty owed by the liquidator of the holding company to said company also extended to the subsidiary company. Briefly, the subsidiary company attempted to hold the liquidators of the holding company liable for failure to safeguard that certain assets belonging to the subsidiary company were insured. The basis for the subsidiary

¹⁸⁵ Supra note 132.

¹⁸⁶ *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd* 1993 (2) SA 784 (C).

¹⁸⁷ At 798-800.

¹⁸⁸ *Adams* supra note 167.

¹⁸⁹ 1993 (2) SA 669 (A).

¹⁹⁰ 1993 (2) SA 743 (A).

company's claim was that before the liquidation of its holding company, the two companies (ie the holding and the subsidiary company) shared the same board of directors, and because the holding company's board was replaced by the liquidators subsequent to the liquidation of the holding company, the liquidators of the holding company also took control of the subsidiary company and therefore owed a duty to the subsidiary company. The court rejected this argument. Botha AR emphatically stated that the liquidators of the holding company owed no legal duty to the subsidiary company, regardless of the fact that the companies shared the same board of directors prior to the liquidation of the holding company. To hold otherwise, so said the court, would be contrary to the Companies Act 61 of 1973.¹⁹¹

As a result of the above decisions by the Appellate Division, it is said that the better view for determining whether or not to lift the corporate veil in the context of a group of companies is that:

[S]ave where the wording or purpose of particular statute or contract justifies the treatment of a holding company and a subsidiary as one corporate entity, the mere fact that a group of companies constitutes a single economic unit does not in itself justify the treatment of the group as a single entity. *The position may be different where the subsidiary is a façade or a sham.*¹⁹²

4.5 Hypothetical scenarios: Applying the doctrine of lifting the corporate veil to the triangular merger structures

4.5.1 Legitimate use

It is evident from the definition of the term 'company'¹⁹³ in s 1 read with s 113 of the Act that, the statutory amalgamation or merger procedure is available only to companies that are incorporated in South Africa. Hence the new statutory procedure cannot be used to effect a cross-border merger between a foreign company (ie a company that is not incorporated in terms of the Act) and a South African company

¹⁹¹ At 747.

¹⁹² Farouk HI Cassim et al op cit note 2 at 55. See also *Adams* supra note 167 at 1019.

¹⁹³ The phrase 'company' is defined in the Act as meaning: '[A] juristic person incorporated in terms of this Act, a domesticated company, or a juristic person that, immediately before the effective date of this Act, was registered in terms of the (i) Companies Act, 1973 (Act 61 of 1973), other than as an external company as defined in that Act; or (ii) Close Corporations Act, 1984 (Act 69 of 1984), if it has subsequently been converted in terms of Schedule 2 [of the Act]; (b) was in existence and recognised as an "existing company" in terms of the Companies Act, 1973 (Act 61 of 1973); or (c) was deregistered in terms of the Companies Act, 1973 (Act 61 of 1973), and has subsequently been registered in terms of this Act'.

(ie a company incorporated in terms of the Act).¹⁹⁴ It is thus likely that foreign companies will incorporate and make use of wholly owned shell subsidiary companies in South Africa to attempt to effect a merger with a South African target company.

The above is an example of the legitimate use of the triangular merger structures.¹⁹⁵ Since it is not the (primary) intention of the holding company to make use of the triangular merger structures so as to circumvent the voting and appraisal rights of its shareholders, or to abuse the said structures in any other way, the contention that the separate legal personality of the subsidiary company ought to be disregarded in order to fix liability elsewhere is strained and will in all likelihood be dismissed by a court if asked to do so under s 20(9) of the Act. As is evident from the above discussion regarding the doctrine of lifting the corporate veil (regardless of whether it is in the context of a single company or a group of companies), a court will only disregard the *Salomon* rule if there are sufficient reasons – based on the facts – to justify such a conclusion. Usually such reasons will include the presence of fraud or dishonesty, or the use of the company's separate legal persona as a cloak or sham to distort or conceal the true facts.

Importantly, the onus is on the applicant shareholder to allege and prove that the primary objective for utilising the triangular merger structures is to circumvent his or her or its voting and appraisal rights and thus that the transaction is one in fraudem legis. As stated by Innes J in *Dadoo*:¹⁹⁶

[A] transaction is in fraudem legis when it is designedly disguised so as to escape the provisions of the law, but falls in truth within these provisions...The transaction contemplated may in truth be within the provisions of the statute, but the parties may call it by a name or cloak it in a guise, calculated to escape those provisions. Such a transaction would be in fraudem legis; the Court would strip off its form and disclose its real nature, and the law would operate.¹⁹⁷

¹⁹⁴ Ezra Davids op cit note 57 at 353-54; Farouk HI Cassim et al op cit note 2 at 684-85.

¹⁹⁵ As mentioned in Chapter 3.6 above, not all companies employ the triangular merger structures solely to circumvent the voting and appraisal rights of their shareholders. Companies may seek to obtain other advantages, for example tax benefits (see Chapter 3.6.1 above), limited liability (see Chapter 3.6.2) and perpetual succession of the would-be acquiring company as well as the target company (see Chapter 3.6.3 above).

¹⁹⁶ *Dadoo* supra note 128.

¹⁹⁷ At 547-48.

As the Act (by way of s 113(2) thereof) seemingly permits the use of the triangular merger structures and fails to expressly address the issue as to whether the triangular merger structures can be utilised to effect a cross-border merger or not, it would be incorrect (based on *Dadoo*) to submit that by implementing said merger structures to effect a cross-border merger the company is per se acting in a manner inconsistent with the Act. Simply put, the company cannot attempt to escape a prohibition that does not exist. On the contrary, in such circumstances the company is merely taking advantage of the full extent of the statutory merger provisions.¹⁹⁸

4.5.2 Used exclusively to circumvent voting and appraisal rights

Assume CoH identifies a viable target company, CoT, which it wants to integrate into its corporate group. CoH is alert to the fact that should it make use of the standard two-party merger structure its shareholders will be entitled to vote on the proposed transaction and, more importantly, that should the shareholders oppose the transaction they will become entitled to appraisal rights. So as to avoid the cash drain associated with the exercise of appraisal rights, CoH decides to make use of one of the triangular merger structures (whether it is the forward triangular merger structure or the reverse triangular merger structure is irrelevant). To put its plan into motion, CoH causes the incorporation of a wholly owned subsidiary company, CoS, and since CoS's exclusive purpose is to effect the merger with CoT, its costs of incorporation is kept to a minimum (at least less than the potential cash drain). As majority shareholder, CoH has the power to – and subsequently uses it – to appoint the board of directors of CoS. Because CoS is merely an acquisition vehicle, all members of its board are also members CoH's board of directors. Thereafter, the board of directors of CoS – as planned well in advance by CoH's board (which, again it must be emphasised, comprises of the same people) causes CoS to enter into a merger agreement with CoT. The merger agreement stipulates, inter alia, that the merger consideration will take the form of shares in CoH (and/or cash stemming from CoH).

As explained in Chapter 3.5 and Chapter 3.6 above, because one of the triangular merger structures is employed, the shareholders of CoH are not entitled to voting or appraisal rights. Prior to the implementation of the triangular merger, however, a minority shareholder of CoH is made aware of the transaction – and he is strongly

¹⁹⁸ See, however, the discussion regarding s 115(4) of the Act in Chapter 5 below.

opposed thereto. The shareholder alleges that CoH settled on the triangular merger structure so as to avoid a dispute with the company's minority shareholders, whose opposition to CoH's board of directors and numbers have grown in recent months. The disgruntled shareholder decides to challenge the implementation of the merger based on the provisions of section 20(9) of the Act.

The application is formulated so that, essentially, the question for determination by the court is whether the triangular merger structure was used exclusively to circumvent the voting and appraisal rights of the applicant shareholder. Stated differently, did CoH make use of and employ CoS as a cloak or façade in order to disguise the true facts of the transaction and/or as a device or sham so as to avoid the rights of the applicant?

First, the applicant shareholder must allege and prove *locus standi*, ie that he is an 'interested person'. As noted in *Ex Parte Gore*,¹⁹⁹ although the term is not defined, there is no mystique surrounding it. If the applicant has a direct and sufficient interest in the relief sought, then the court should allow the proceedings to continue. Based on the facts provided, the applicant is a shareholder of the company (CoH) which instigated the merger and, importantly, will provide the merger consideration. Consequently, the implementation of the proposed merger transaction will impact on the applicant's current shareholding and share value (see Chapter 3.7 above).

Secondly, the applicant must allege and prove that the use by CoH of CoS constitutes an unconscionable abuse of the juristic personality. As discussed,²⁰⁰ there are no set categories for determining when a court will disregard the separate legal personality of a company. Instead, each case necessitates an inquiry into the facts which, once determined, will be of decisive importance.²⁰¹ Also, as was recently confirmed by Binns-Ward J in *Ex Parte Gore*, by conducting an inquiry into the facts, the court will adopt a balancing approach:

[T]he determination to disregard the distinctness provided in terms of a company's separate legal personality appears in each case to reflect a policy-based decision resultant upon a weighing by the court of the importance of giving effect to the legal concept of juristic personality, acknowledging the

¹⁹⁹ Supra note 136.

²⁰⁰ See Chapters 4.2, 4.3 and 4.4 above.

²⁰¹ *Cape Pacific* supra note 131 at 802; *Hülse-Reutter* supra note 135 at 1346.

material practical and legal considerations that underpin the legal fiction, on the one hand, as against the adverse moral and economic effects of countenancing an unconscionable abuse of the concept by the founders, shareholders, or controllers of a company, on the other.²⁰²

Importantly, in balancing the conflicting values, a court should have regard to the substance of the transaction in question, as opposed to its form only,²⁰³ and the intention or motive of the parties involved (ie CoH's objective for making use of the triangular merger structures is of paramount importance and may be a determining factor).²⁰⁴

Taking into consideration the principles and case law cited and discussed up until this point, the use by CoH of a wholly owned subsidiary company, CoS, purely to circumvent the voting and appraisal rights of CoH's shareholders is a clear abuse of the *Salomon* rule and therefore should not be endorsed by a court of law. Clearly, CoS is nothing but an instrument (or 'puppet' as per Lord Denning in *Wallersteiner*²⁰⁵) for and of CoH. It is used by CoH as a cloak, a façade, a device and/or a stratagem to distort the facts and to hide its true ambitions. Although not decisive, CoS's shares is owned entirely by CoH, which enables the latter to control CoS's every movement. To use the words of Lord Denning MR in *DHN Food Distributors*, CoS is 'bound hand and foot' to CoH and is subject to the latter's absolute control.²⁰⁶ It was founded in treachery and deceit. What is more, CoS is a shell company devoid of any assets or resources. As observed by the court in *FG Films*, such a company is an 'insignificant company'²⁰⁷ and thus its corporate form ought to be disregarded.

The question that remains to be answered is: what is the appropriate order? This should depend on whether the merger agreement has been effected or not. According to the facts provided, the merger has not been implemented; therefore, CoH should be ordered to submit the merger agreement to its shareholders in accordance with s 115, who will then be entitled to vote on the merger (and perhaps stop it from being

²⁰² Para 29.

²⁰³ *Dadoo* supra note 128 at 547.

²⁰⁴ See, for example, *Cape Pacific* supra note 131 at 799, 802-06; *Adams* supra note 167 at 1024 where it was said that: '[W]here a façade is alleged, the motive of the perpetrator may be highly material'.

²⁰⁵ Supra note 180 at 238.

²⁰⁶ Supra note 171 at 467.

²⁰⁷ Supra note 176 at 616.

implemented) and to exercise their right of appraisal, should they so desire. Such an order, if submitted, falls within the scope of s 20(9)(b) of the Act.²⁰⁸ If, however, the merger agreement has already been effected, then the applicant ought to be entitled to receive the fair value of his or her or its shares as determined by the court in accordance with s 164 of the Act.²⁰⁹

4.6 Conclusion

A consideration of legal authorities establishes that the only certainty regarding the circumstances that will move a court to disregard the separate legal personality of a company is that it is uncertain. Nevertheless, judicial decisions prior to the incorporation of s 20(9) of the Act clearly established that the inquiry comprises a balancing act and that each matter should be decided, based on the facts presented to the court. In this regard, the presence of fraud, dishonesty, improper conduct or the absolute control by one person over the subsidiary may very well be of decisive importance. This approach and the continued authority of previous judicial decisions relating to lifting the corporate veil was confirmed in, *Ex Parte Gore*, the first judgment pertaining to s 20(9) of the Act.

Yet the impact of *Ex Parte Gore* goes much further. The judgment not only broadens the basis upon which a court may disregard the corporate persona, but also establishes unequivocally that the remedy will in future be available ‘whenever the illegitimate use of the concept of juristic personality adversely affects a third party in a way that reasonably should not be countenanced’.²¹⁰ The judgment also puts to rest the notion that the remedy is exclusive (ie that it can only be relied on in the absence of another remedy) and confirms that a court has wide discretionary powers to make any order it deems appropriate in the circumstances. All things considered, the judgment sends a strong warning to those persons in control of companies or company groups to not abuse the corporate form.²¹¹

²⁰⁸ Section 20(9)(b) of the Act, as quoted in Chapter 4.3 above, authorises a court to make any order the court considers appropriate to give effect to its decision disregard the separate legal personality of a company.

²⁰⁹ See, for example, the US judgment in *McMillan* supra note 75.

²¹⁰ Para 34.

²¹¹ Rehana Cassim (2013) op cit note 151 at 37.

Option 2: Filing a complaint with the relevant regulatory agency

5. REGULATORY AGENCIES

5.1 Introduction

The second possible remedy for those shareholders who are excluded from the voting and appraisal process due to the application of any of the two triangular merger structures is to file a complaint with the relevant regulatory agency based on the provisions of s 115(4) of the Act.²¹² In effect, the aforementioned statutory provision excludes certain persons from the voting procedure,²¹³ which, as will be explained, may altogether prevent the use of the triangular merger structures in South Africa.

The first step, however, is to establish which regulatory agency has jurisdiction to resolve a complaint. In this regard, s 115(1) of the Act stipulates, inter alia, that to the extent Part B or Part C of the Act and the Takeover Regulations 2011 ('the Takeover Regulations') is applicable, a merger may not be implemented unless the Panel has issued a compliance certificate in respect of the transaction. Hence the holding back by the said agency of a compliance certificate will prevent the implementation of the proposed transaction. Not all companies, however, are subject to the jurisdiction of the Panel. This then necessitates further action by or on behalf of the disgruntled shareholder in order to prevent the carrying out of the transaction.

5.2 The Takeover Regulation Panel

The newly established Takeover Regulation Panel is the legislative authority responsible for overseeing all affected transactions or offers in accordance with Parts B and C of the Act and the Takeover Regulations.²¹⁴ An 'affected transaction' includes, inter alia, an amalgamation or merger ('merger') if it involves at least one regulated company,²¹⁵ which is defined as 'a company to which [Part B] and Part C [of the Act] and the Takeover Regulations apply, as determined in accordance with s 118(1) and (2) [of the Act]'.²¹⁶ Section 118(1) of the Act goes on to stipulate that:

²¹² Importantly, there seems to be no reason why the disgruntled shareholder cannot rely on the provisions of s 115(4) of the Act to apply directly to court.

²¹³ See Chapter 5.4.1 below for the wording of s 115(4) of the Act.

²¹⁴ Section 119(1) of the Act.

²¹⁵ Section 117(1)(c)(ii) of the Act.

²¹⁶ Section 117(1)(i) of the Act.

Subject to subsections (2) and (4), [Part B], Part C and the Takeover Regulations apply with respect to an affected transaction or offer involving a profit company or its securities if the company is –

- (a) a public company;
- (b) a state-owned company, except to the extent that any such company has been exempted in terms of section 9; or
- (c) a private company, but only if –
 - (i) the percentage of the issued securities of that company that have been transferred, other than by transfer between or among related or inter-related persons, within the period of 24 months immediately before the date of a particular affected transaction or offer exceeds the percentage prescribed in terms of subsection (2); or
 - (ii) the Memorandum of Incorporation of that company expressly provides that the company and its securities are subject to [Part B], Part C and the Takeover Regulations, irrespective of whether the company falls within the criteria set out in subparagraph (i).

The percentage referred to in s 118(1)(c)(i) of the Act, as quoted above, is limited in s 118(2) of the Act to not less than 10 per cent of the issued securities of the company, which is also the percentage currently applicable.²¹⁷ Consequently, a private company that has transferred more than 10 per cent of its issued shares within a period of 24 months prior to the merger (other than between related or inter-related persons), or has voluntarily rendered itself subject to the provisions of Parts B and C of the Act and the Takeover Regulations, is deemed a regulated company.

Thus, to sum up: if a transaction – including a merger – involves at least one regulated company (being all public companies and some private companies), then it is deemed to constitute an affected transaction, and wherefore it is the duty of the Panel to investigate and regulate such matters in accordance with Parts B and C of the Act and the Takeover Regulations.²¹⁸

²¹⁷ Regulation 91(1) of the Takeover Regulations.

²¹⁸ Sections 119(1) and 201(1)(a) of the Act.

5.3 The Companies and Intellectual Property Commission

The Commission is a newly established and independent legislative body with jurisdiction throughout South Africa.²¹⁹ It has various objectives, including the promotion of compliance with the provisions of the Act, which it must enforce by, inter alia, receiving or initiating complaints concerning alleged contraventions of the Act.²²⁰

Section 168(1) of the Act provides that any person may file a complaint in writing with the Commission in respect of any provision of the Act which does not fall within the jurisdiction of the Panel (as discussed in Chapter 5.2 above). Accordingly, all non-regulated companies (being companies that fall outside of the jurisdiction of the Panel) are subject to the supervision of the Commission.

5.4 Application for exemption

Regulated as well as non-regulated companies may apply for an exemption from any prohibition or requirement set out in the Act. With regard to regulated companies, s 119(6) of the Act provides that:

The Panel may wholly or partially, and with or without conditions, exempt an offeror to an affected transaction or an offer from the application of any provision of [Part B], Part C or the Takeover Regulations if –

- (a) there is no reasonable potential of the affected transaction prejudicing the interests of any existing holder of a regulated company's securities;
- (b) the cost of compliance is disproportionate relative to the value of the affected transaction; or
- (c) doing so is otherwise reasonable and justifiable in the circumstances having regard to the principles and purposes of [Part B], Part C and the Takeover Regulations.²²¹

On the other hand, non-regulated companies may rely on s 6(2) of the Act in order to obtain an exemption from the Companies Tribunal. The aforementioned section reads as follows:

A person may apply to the Companies Tribunal for an administrative order exempting an agreement, transaction, arrangement, resolution or provision of a company's Memorandum of Incorporation or rules from any prohibition or

²¹⁹ Section 185 of the Act.

²²⁰ Section 187(2)(c) of the Act.

²²¹ See also s 6(2) of the Act, which is quoted in the following paragraph.

requirement established by or in terms of an unalterable provision of [the] Act, other than a provision that falls within the jurisdiction of the Panel.

If no exemption is applied for or granted, all statutory provisions relating to the particular transaction will apply in their entirety.

5.5 Initiating complaints

Any person may file a written complaint with (i) the Panel in respect of a matter contemplated in Parts B and C of Chapter 5 of the Act or the Takeover Regulations; or (ii) the Commission with regard to any other matter, alleging that a person has acted in a manner contrary to or has transgressed any of the provisions of the Act or of the relevant company's Memorandum of Incorporation or rules.²²²

Section 168(1) of the Act provides extensive standing to would-be applicants in that any person who alleges a contravention of the Act, the relevant company's Memorandum of Incorporation and/or its rules can file a complaint with the Panel or the Commission (depending on the jurisdiction of each statutory body). Hence an applicant need not be a shareholder of the company against which a complaint is filed; meaning that the use of the triangular merger structures will not prevent a shareholder of the holding company (CoH) from approaching the Panel or the Commission for relief.

Once a complaint has been submitted to the Panel or the Commission, the relevant body may (i) issue a notice to the complainant advising the complainant that the matter will not be investigated due to the complaint being deemed frivolous or vexatious, or because the complainant failed to allege sufficient facts to substantiate a prima facie case; (ii) refer the matter to the Companies Tribunal or other accredited agency; or (iii) direct an inspector or investigator to consider the complaint.²²³ Thus the filing of a complaint does not guarantee that the matter will be investigated by the Panel or the Commission. Besides, even if the complaint is accepted by the Panel or the Commission and an inspector or investigator is appointed, the time allowed for making a finding is indefinite as the Act only stipulates that the complaint must be investigated 'as quickly as practicable'.²²⁴

²²² Section 168(1) of the Act.

²²³ Section 169(1) of the Act.

²²⁴ Section 169(1)(c) of the Act.

After receiving the report from the inspector or investigator who has been appointed to conduct the inquiry, the Panel or Commission may, inter alia, (i) excuse any respondent mentioned in the complaint; (ii) refer the complaint to the Companies Tribunal or to each other (ie the Panel may refer the matter to the Commission and vice versa); (iii) issue a notice of non-referral to the complainant; (iv) in the case of the Commission, propose that the complainant meet with the Commission or the Companies Tribunal so as to resolve the matter by consent; (v) commence court proceedings in the name of the complainant; or (vi) cause a compliance notice to be issued.²²⁵

5.6 Hypothetical scenario

5.6.1 Private or regulated companies

CoH (Ltd) proposes a merger between its newly incorporated and wholly owned subsidiary, CoS (Pty) Ltd, and a target company, CoT (Ltd). The merger agreement stipulates that the shareholders of CoT (Ltd) will receive a cash pay-out as consideration for their shares and that subsequent to the implementation of the merger CoT (Ltd) will continue in existence as the surviving merged company and wholly owned subsidiary of CoH (Ltd). Since CoS (Pty) Ltd was established exclusively for the purpose of effecting the proposed merger, it has no assets to speak of and thus the merger agreement stipulates that the merger consideration will be provided by CoH (Ltd). None of the aforementioned companies applied for an exemption in terms of s 119(6) of the Act.

A minority shareholder of CoH (Ltd) ('shareholder A') becomes aware of the pending merger and is opposed thereto for various reasons. Shareholder A elects to file a complaint with the Panel (see Chapter 5.2 and Chapter 5.5 above), naming all three companies as respondents. Shareholder A basis his complaint on the voting requirements set out in s 115(4) of the Act, which reads as follows:

For the purposes of [calculating the voting and quorum requirements for an amalgamation or merger], 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 –

²²⁵ Section 170(1) of the Act.

- (a) required to be present, or actually present, in determining whether the applicable quorum requirements are satisfied; or
- (b) required to be voted in support of a resolution, or actually voted in support of the resolution.

Essentially, it is shareholder A's contention that CoH (Ltd) and CoS (Pty) Ltd are 'related persons', as defined in s 2(1)(c)(ii) of the Act²²⁶ and thus that CoH (Ltd) – which is the only shareholder of CoS (Pty) Ltd – is excluded from the voting process. An alternative contention is that CoH (Ltd) and CoS (Pty) Ltd are persons 'acting in concert', as envisioned in s 117(1)(b)²²⁷ and thus that CoH (Ltd) – which is the only shareholder of CoS (Pty) Ltd – is excluded from the voting process. Shareholder A therefore challenges CoH's 'right' to vote and the overall validity of the voting process. Based on these submissions, the Panel accepts the complaint and notifies the parties of its intention to investigate the matter.

The problem for all parties concerned is the inconsistency between s 113(2) and s 115(4) of the Act. As noted in Chapter 3.4, above, the various types of merger consideration (see s 113(2) of the Act) seemingly sanctions the use of the triangular merger structures. Section 115(4) of the Act, however, clearly excludes the only shareholder (the holding company) of the subsidiary company from the voting process. Hence the Act is unclear as to whether the use of the triangular merger structures is allowed or not, and/or the extent to which s 115(4) of the Act is (if at all) applicable. What compounds the problem even further is that the Panel is tasked with regulating affected transactions and investigating complaints 'in accordance with the Act', ie it is tasked to apply the law, not to make it.²²⁸ If, therefore, the Act is unclear, the authority of the Panel to sanction the implementation of a triangular merger also becomes unclear – which is to the advantage of shareholder A.

What is more, the general interpretation section, that is s 5 of the Act, is of no assistance. Section 5(1) of the Act stipulates that '[the] Act must be interpreted and applied in a manner that gives effect to the purposes set out in section 7 [of the Act]'

²²⁶ Section 2(1)(c)(ii) of the Act stipulates that 'a juristic person is related to another juristic person if either is a subsidiary of the other', which is indeed the relationship between CoH (the holding company) and CoS (the wholly owned subsidiary of CoH).

²²⁷ The phrase 'act in concert' is defined in s 117(1)(b) of the Act a meaning: [A]ny action pursuant to an agreement between or among two or more persons, in terms of which any of them co-operate for the purpose of entering into or proposing an affected transaction or offer'. In terms of s 117(2) of the Act 'two or more related or inter-related persons are considered to act in concert unless the contrary is established'. Hence the onus is on the respondent(s) to prove otherwise.

²²⁸ Section 193 of the Act.

which, by and large, states that the Act must be interpreted so as to promote the economic welfare of individuals and the country as a whole. Having said that, s 119(1)(a) of the Act, nevertheless, goes on to stipulate that the Panel must regulate any affected transaction or offer in accordance with Parts B and C of the Act and the Takeover Regulations ‘without regard to the commercial advantages or disadvantages of the transaction’ so as to ‘ensure the integrity of the marketplace and fairness to [the shareholders] of regulated companies’.²²⁹

The Panel will thus have to apply s 115(4) of the Act strictly. This means that, based on the definition of ‘related persons’ and/or ‘act in concert’, CoS (Pty) Ltd’s only shareholder, CoH (Ltd), is not entitled to vote its shares in favour of the proposed merger between CoS (Pty) Ltd and CoT (Ltd), resulting in the illegality (or perhaps better said, the impossibility) of the transaction. As such, the Panel must disregard CoH’s vote and/or must not issue a compliance certificate.

5.6.2 Private or non-regulated companies

For purposes of this hypothetical scenario the facts are the same as in Chapter 5.6.1 above, except that CoH, CoS and CoT are all private non-regulated companies that did not apply for an exemption in terms of s 6(2) of the Act, prompting shareholder A to submit his written complaint to the Commission.

As Parts B and C of the Act and the Takeover Regulations do not apply to non-regulated companies, the participating companies are not required to obtain a compliance certificate from the Panel prior to implementing the proposed merger. Section 115(4) of the Act is, however, still applicable and, in conjunction with the definition of ‘related persons’ and ‘act in concert’, will provide shareholder A with a statutory basis for submitting a complaint to the Commission so as to prevent the merger.²³⁰

Filing a complaint with the Commission has, nevertheless, one essential weakness: it does not necessarily prevent the implementation of a merger. This is because, as noted above, it is not a prerequisite for non-regulated companies to obtain a

²²⁹ Furthermore, s 201(3) of the Act stipulates that: ‘In exercising its powers and performing its functions the Panel must not express any view or opinion on the commercial advantages of any transaction or proposed transaction’.

²³⁰ The meaning of the phrase ‘act in concert’, as set out in s 117(1)(b) of the Act (see footnote 226 above), remains applicable to s 115(4) of the Act, see s 115(4A) of the Act.

compliance certificate before and in order to implement a merger. Instead, all that must be done to effect a merger is for the shareholders of the constituent companies to vote in favour thereof. Consequently, in order to prevent the implementation of the proposed merger, shareholder A must also obtain a court interdict prohibiting the constituent companies from implementing the transaction.²³¹ Yet this prompts the question as to whether shareholder A would not be best advised to launch an application directly to court, based on the provisions of s 115(4) of the Act (and, in the alternative, s 20(9) and/or s 163) and in terms of which shareholder A requests the court to prohibit the implementation of the merger until such time the merits of the application has been fully traversed and the court has made its ruling. The option ought to be discussed and a decision will have to be made as to how to proceed. In either event, the wording of s 115(4) of the Act should suffice to prevent the implementation of the merger based on the fact that CoH (Pty) Ltd and CoS (Pty) Ltd are ‘related persons’ and/or ‘act in concert’.

5.7 Conclusion

The potential impact of s 115(4) of the Act on the shareholder voting requirements, particularly in the context of the triangular merger structures, is immense. At present there exists no authoritative work and/or judicial precedent on the impact of s 115(4) of the Act on the triangular merger structures. It thus remains to be seen whether the said section will indeed be utilised by a holding company’s dissenting shareholders to challenge the implementation of a triangular merger. Nonetheless, based on a literal interpretation of s 115(4) of the Act, shareholders ought to be able to challenge and prevent the implementation of a triangular merger.

Notably, neither the Model Business Corporations Act nor the Delaware General Corporation Law contains a provision similar to s 115(4) of the Act, at least not to the extent that s 115(4) of the Act can be interpreted so as to prevent the legitimate (or manifest) use of the triangular merger structures. Considering that the South African amalgamation or merger provisions are largely based on US law, it is doubtful whether the legislator fully appreciated the effect of s 115(4) of the Act – this is especially so considering the obvious discrepancy between the said section and s

²³¹ It is also within the powers of the Commission to refer the matter to a court of law (see s 187 of the Act), in which case an interdict can also be obtained; however, urgency would most likely demand that the shareholder take matters into his own hands and approach the courts directly.

113(2) of the Act, as well as the general consensus amongst South African legal authorities that s 115(4) of the Act is (only) intended to protect minority shareholders in situations where the acquirer stands on both sides of the transaction.²³²

6. THE DE FACTO MERGER DOCTRINE

6.1 Introduction

The claim by shareholders that they are entitled to the very rights which their company sought to avoid falls within the purview of the de facto merger doctrine. The aforementioned doctrine originated in the US during the late 1950s in response to the development and use of different (or a combination of) business combination techniques to subvert shareholder rights.²³³ Significantly, there existed no statutory basis for the aforesaid doctrine; on the contrary, it developed by way of the judiciary (ie, by way of judicial decisions, similar to South African common law).

Not all US courts, however, approve of the de facto merger doctrine. Instead they favour an approach based on the theory of ‘independent statutory significance’, otherwise known as ‘the equal dignity rule’.²³⁴

6.2 Definitions

A claim in terms of the de facto merger doctrine entails an attempt to recast the transaction in form, usually as a standard two-party statutory merger. The doctrine’s premise is simple: if a transaction has the characteristics and consequences of a merger, then it must be treated as such, regardless of the label attached to it by the parties to the transaction.²³⁵ Should the doctrine be applied, the applicant shareholder will become entitled to the rights generally associated with a statutory merger, including the right to vote and to opt out of the company.²³⁶

In contrast, the equal dignity rule demands that the legality of a transaction be determined solely with reference to the most relevant and applicable statutory provi-

²³² See Chapter 3.3.2 (b) above.

²³³ See *Farris* supra note 18; Gilson & Black op cit note 8 at 673.

²³⁴ See, for example, *Farris* supra note 18; *Applestein v United BD & Carton Corp* 159 A 2d 146 (NJ Super App Div, 1960); *Rath v Rath Packing Co* 136 NW 2d 410 (Iowa, 1965) for instances where the courts applied the de facto merger doctrine. On the other hand, see, for example, *Hariton v Arco Electronics Inc* 188 A 2d 123 (Del, 1963); *Orzeck v Englehart* 195 A 2d 375 (Del, 1963) for cases where the courts refused to apply the de facto merger doctrine based on the equal dignity rule (note the seat of the court).

²³⁵ Eisenberg op cit note 18 at 219.

²³⁶ Gilson & Black op cit note 8 at 673.

sion. Stated differently, one statutory provision cannot be tested against the demands of another.²³⁷ Notably, the label attached to the transaction by the constituent parties is often the decisive factor.

6.3 Judicial debate

The conflict between the de facto merger doctrine and the equal dignity rule is evident from the judgments in *Farris v Glen Alden Corp*, a decision by the Pennsylvania Supreme Court,²³⁸ and *Hariton v Arco Electronics*, a ruling by the Delaware Supreme Court.²³⁹

6.3.1 The *Farris* judgment

In October 1957 List Industries Corporation ('List') purchased through a wholly owned subsidiary company 38.5 per cent of the shares of Glen Alden Corporation ('Glen Alden'). The acquisition enabled List to place three of its directors on Glen Alden's board of directors. Thereafter, in March 1958, List and Glen Alden entered into a 'reorganisation agreement', subject to shareholder approval. The agreement contemplated the following actions: (i) Glen Alden was to acquire all of the assets and assume all of the liabilities of List; (ii) Glen Alden was to increase its authorised shares without bestowing any pre-emptive rights to its current shareholders and issue such shares to List, which were then to be distributed to the List shareholders as consideration for their shares in List; (iii) Glen Alden was to change its name to List Alden Corporation ('List Alden'); (iv) the directors of Glen Alden and List were to become directors of List Alden; and (v) List Alden was to carry on the operations of List, which would be dissolved as a consequence of the transaction. Glen Alden's shareholders were informed of the proposed transaction and subsequently approved the transaction at a shareholders' meeting.

The plaintiff, a Glen Alden shareholder, contested the validity of the obligatory shareholder notice and subsequent approval of the transaction on the grounds that the notice (i) failed to inform the Glen Alden shareholders that the true purpose of the shareholders' meeting was to authorise a merger between Glen Alden and List; (ii)

²³⁷ Eisenberg op cit note 18 at 219.

²³⁸ *Farris* supra note 18.

²³⁹ *Hariton* supra note 234.

failed to advise the Glen Alden shareholders of their voting and appraisal rights, as required; and (iii) did not contain copies of pertinent sections of the Act, as required.

The defendant, Glen Alden, denied that the allegations gave rise to a cause of action as the transaction was a purchase and sale of assets; hence the Glen Alden shareholders were not entitled to appraisal rights.²⁴⁰ In addition, the defendant relied on a 1957 legislative amendment which provides that ‘the right of dissenting shareholders...shall not apply to the purchase by a corporation of assets whether or not the consideration therefor be...shares...of such corporation...’.²⁴¹

The Supreme Court of Pennsylvania held that the transaction complained of constituted a de facto merger. The court emphasised the importance of considering the consequences of the transaction complained of, as well as the purpose of the provisions that the applicant wanted to enforce. Also, in delivering the judgment of the court, Cohen J rejected the defendant’s reliance on the 1957 legislative amendments:

The amendments of 1957 do not provide that a transaction between two corporations which has the effect of a merger but which includes a transfer of assets for consideration is to be exempt from the protective provisions of [the merger sections]. They provide only that the shareholders of a corporation which acquires the property or purchases the assets of another corporation, without more, are not entitled to the right to dissent from the transaction. So, as in the present case, when as part of a transaction between two corporations, one corporation dissolves, its liabilities are assumed by the survivor, its executives and directors take over the management and control of the survivor, and, as consideration for the transfer, its stockholders acquire a majority of the shares of stock of the survivor, then the transaction is no longer simply a purchase of assets or acquisition of property...but a merger governed by [the merger provisions]. To divest shareholders of their right of dissent under such circumstances would require express language which is absent from the 1957 amendments.²⁴²

6.3.2 The *Hariton* judgment

The defendant, Arco Electronics Inc (‘Arco’), and Loral Electronics Corporation (‘Loral’) entered into a ‘reorganisation agreement plan’, which provided as follows:

²⁴⁰ Under the law applicable at the time, a sale of substantially all of the assets of a company did not trigger appraisal rights, whereas a merger did.

²⁴¹ At 30.

²⁴² At 31.

(i) Arco was to sell all of its assets to Loral; (ii) as consideration for the sale of assets, Arco would receive Loral shares, which would then be distributed amongst Arco shareholders; and (iii) Arco would be dissolved subsequent to the implementation of the reorganisation plan. Arco notified its shareholders of the proposed sale of assets, which was then approved by 80 per cent of Arco shareholders.

The plaintiff, a shareholder of Arco, sued to prevent the implementation of the agreement. The plaintiff contended that the agreement constituted a merger and yet he was not afforded appraisal rights by the company.

Although the court conceded that a sale of assets coupled with the planned distribution of Loral shares to Arco shareholders, and the obligatory dissolution of Arco would achieve the same result as a merger between said companies, it still held against the plaintiff. Southerland CJ emphasised the independence of the statutory provisions pertaining to a sale of assets from those provisions relating to a merger:

We now hold that the reorganization here accomplished through [section] 271 [of the Delaware General Corporation Law] and a mandatory plan of dissolution and distribution is legal. This is so because the sale-of-assets statute and the merger statute are independent of each other. They are, so to speak, of equal dignity, and the framers of a reorganization plan may resort to either type of corporate mechanics to achieve the desired end.²⁴³

Therefore, to sum up, whereas the court in *Farris* held that the effect of the transaction and the purpose of the relevant statutory provisions ought to be the ultimate determining factors for awarding shareholder rights, the court in *Hariton* stressed the individuality of statutory provisions. Thus, based on the *Hariton* decision, if a transaction is structured in accordance with a particular statutory provision, it is not open for a party to test the actions of the company under a different provision.²⁴⁴

6.4 Triangular transactions

The use of the de facto merger doctrine to recast a triangular merger was tested in *Terry v Penn Central Corp.*²⁴⁵ Penn Central Corporation ('Penn Central') had sought to acquire Colt Industries Inc ('Colt') by making use of one of its wholly owned

²⁴³ At 125.

²⁴⁴ Eisenberg op cit note 18 at 221-22.

²⁴⁵ 668 F 2d 188 (3d Cir, 1981).

subsidiary companies, PCC Holdings Inc ('PCC'). The merger agreement, which *inter alia* provided that the shareholders of Colt will receive shares in Penn Central as compensation for their Colt shares, was drafted and a date was fixed for the shareholders of PCC, ie Penn Central, to vote on the proposed merger.

The appellants, Terry and Hunt, who were both shareholders of Penn Central, became aware of the planned merger between Colt and PPC and the pending shareholders' meeting. The appellants objected to the transaction, and sought not only to enjoin the implementation thereof, but also the meeting of PCC shareholders. They first approached the District Court arguing, *inter alia*, that as shareholders of Penn Central – the company behind the proposed merger – the transaction would impact on their shareholding, and therefore they are entitled to voting and appraisal rights if the transaction is approved. The court *a quo* rebuffed their submissions.

Nevertheless, at the subsequent shareholders' meeting, PPC's shareholders (for reasons not apparent from the judgment) voted against the proposed merger, prompting Colt and PPC to abandon the transaction. Although this rendered the appellant's case moot, Penn Central's *modus operandi* was still subject to scrutiny since it had previously employed and proposed to once more make use of the same technique to effect other business combinations. Thus, as the question appeared 'likely to recur in future',²⁴⁶ the US Court of Appeals, Third Circuit, proceeded to determine, *inter alia*, whether the *de facto* merger doctrine can be used in order to recast the transaction as a merger by and between Colt (the target company) and Penn Central (the holding company), which would then afford voting and appraisal rights to the appellants.

The court started off by noting that at the consummation of the proposed merger, both Penn Central and PPC would survive as separate entities and therefore Penn Central is not a party to the merger.²⁴⁷ Secondly, with regard to the appellant's argument that the transaction nevertheless falls within the purview of the *de facto* merger doctrine, the court traced the origin and development of the doctrine and, highlighting the impact of a 1959 legislative amendment, concluded that the doctrine cannot be invoked so as to provide the appellants the relief originally sought by them. The court stated as follows:

²⁴⁶ At 190.

²⁴⁷ At 192-93.

In a 1959 response to [*Farris v Glen Alden Corp*²⁴⁸], the legislature made explicit its objection to earlier cases that found certain transactions to be de facto mergers....Following this explicit statement, the de facto merger doctrine has rarely been invoked by the Pennsylvania courts...Although [*In re Jones & Laughlin Steel Corp*²⁴⁹] suggests that dissent and appraisal rights might be available if fraud or fundamental unfairness were shown, we are not faced with such a situation. No allegation of fraud has been advanced....In the absence of any explicit guidance to the contrary by the Pennsylvania courts, we conclude that the language of the legislature in 1959 precludes a decision that the transaction in this case constitutes a de facto merger sufficient to entitle Penn Central shareholders to dissent and appraisal rights.²⁵⁰

6.5 Conclusion

The de facto merger doctrine started off as an attempt by certain judges to ensure the equitable treatment of shareholders. By emphasising the substance and ultimate effect of a transaction, the courts prevented corporations from subverting the main purpose of the merger and appraisal provisions. However, largely owing to a concerted effort by the legislator, the doctrine has by and large lost its foothold in US corporate law, although, as is apparent from the *Terry* decision, the presence of fraud may still persuade a court to apply the doctrine and give effect to the commercial realities of the situation.

It remains to be seen with what new methods shareholders in the US will come up with in order to challenge transactions that are obviously designed to undermine their statutory rights, and to what extent the legislator will interject, if at all. Perhaps the next strategy will be to attempt to lift the veil of incorporation.

7. THE OPPRESSION REMEDY

7.1 Introduction

The oppression remedy, as set out in s 163 of the Act, affords those shareholders and/or directors of a company who feel that they are being subjected to oppressive or prejudicial conduct, or that their interests are being unfairly disregarded by the company, with the necessary statutory basis to apply to court for relief. In general, the

²⁴⁸ Supra note 18. See also Chapter 6.3.1 above.

²⁴⁹ 412 A 2d 1099 (Pa, 1980).

²⁵⁰ At 193-94.

oppression remedy has broadened the authority of the judiciary to ‘intervene in intra-corporate affairs’ and to determine the fairness of an act or omission by or on behalf of a company or a related person.²⁵¹ As has correctly been observed:

Most judges accept that their role with respect to the oppression remedy is to judge upon the fairness of the actions of management and the majority of shareholders in order to protect the minority from unfair treatment.²⁵²

Significantly, the oppression remedy not only provides a broad and open-ended basis whereby a shareholder may challenge the conduct of the company or related person, but also allows a court to make a variety of orders,²⁵³ including an order directing the company to purchase the shares of the disgruntled minority shareholder.²⁵⁴

7.2 Statutory codification

Section 163(1) of the Act reads as follows:

A shareholder or a director of a company may apply to court for relief if:

- (a) any act or omission of the company, or a related person, has had a result that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of, the applicant;
- (b) the business of the company, or a related person, is being or has been carried on or conducted in a manner that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of, the applicant; or
- (c) the powers of a director or prescribed officer of the company, or a person related to the company, are being or have been exercised in a manner that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of, the applicant.

Four points are immediately discernible from the wording of s 163(1) of the Act. First, a shareholder or a director of a company may apply to court for relief.

²⁵¹ Brian Cheffins ‘The oppression remedy in corporate law: The Canadian experience’ (1988) 10:3 *U Pa J Int’l Bus L* 305 at 314.

²⁵² Ibid. See also *Sparling v Javelin International Ltd* [1986] RJQ 1073; *Mason v Intercity Properties* 37 BLR (Ont CA, 1987); *Re Ferguson & Imax Systems Corp* 43 OR 2d (Ont CA, 1983).

²⁵³ See s 163(2) of the Act.

²⁵⁴ The various orders listed in s 163(2) of the Act do not represent a closed list. With regard to the purchase price of the shares, in *Scottish Co-operative Wholesale Society Ltd v Meyer* [1958] 3 All ER 66 (HL) at 86 Lord Keith remarked that, the purchase, as determined by the court, will be ‘the value of the shares at the commencement of the proceedings had it not been for the effect of the oppressive conduct’.

Secondly, an applicant is not required to be a shareholder or a director of the company against which the grievance is filed. Instead, a person will have locus standi for purposes of s 163 of the Act if he or she or it is a shareholder or a director of the relevant company or a company related to the relevant company.²⁵⁵ The phrase ‘related person’, as defined in s 2 of the Act, includes a holding and subsidiary company relationship.²⁵⁶ Therefore, in the context of a triangular merger, the applicant may be a shareholder or director of the holding company (ie CoH) or the subsidiary company (ie CoS). Thirdly, a person (whether shareholder or director of the company or related person) may rely on s 163 of the Act to complain of an act or omission by the company or a related person. Fourthly, the phrase ‘the business of the company’, which is not defined in the Act, is very wide and may include both external and internal company management activities.²⁵⁷

In order to succeed with an application in terms of s 163 of the Act, an applicant must allege and prove that the conduct complained of ‘*has had a result* that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of, the applicant’.²⁵⁸ The inquiry, therefore, focusses on the result of the conduct complained of, as opposed to the conduct itself.²⁵⁹ Accordingly, ‘no relief will be available in respect of threatened conduct’.²⁶⁰

7.3 Conduct that is oppressive, unfairly prejudicial or unfairly disregards the interests of the applicant

The Act does not provide guidance as to what precisely would amount to ‘unfairly prejudicial’ and/or ‘oppressive’ conduct, nor does it provide any direction as to the

²⁵⁵ This can be compared to s 252 of the Companies Act 61 of 1973 which provided standing only to the shareholders of the relevant company, ie to the shareholders of the company accused of oppressive or prejudicial conduct.

²⁵⁶ Section 2(c)(ii) of the Act provides that: ‘[A] juristic person is related to another juristic person if either is a subsidiary of the other’. See also *Peel v Hamon J&C Engineering (Pty) Ltd* 2013 (2) SA 331 (GSJ); *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd* (WCC) unreported case no 15854/13 (19 June 2014); Henochsberg, Edgar S *Henochsberg on the Companies Act 71 of 2008* issue 7 Delpport Piet A (ed) (2014) 567-74(4).

²⁵⁷ Farouk HI Cassim et al op cit note 2 at 766.

²⁵⁸ Section 163(1) of the Act, as quoted above.

²⁵⁹ WA Joubert *The Law of South Africa* Vol 4, Part 1 (2013) para 313, footnote 1.

²⁶⁰ Farouk HI Cassim et al op cit note 2 at 765. See also, for example, *Porteus v Kelly* 1975 (1) SA 219 (W) at 222 where it was said in respect of s 252 of the Companies Act 61 of 1973: ‘But something to be done in the future is not yet an “act”, which is something done or performed; and, although the calling of a meeting is an “act”, such calling in itself be “unfairly prejudicial, unjust or inequitable” to the applicant...It may well be that in this, as in other cases, prevention of an act would be better than curing it after it has been committed, but the answer is that the section does not provide therefor’.

type of conduct that would be deemed to ‘unfairly disregard the interests of’ the applicant. Nevertheless, as held in *Peel v Hamon J&C Engineering (Pty) Ltd*²⁶¹ and *Visser Sitrus (Pty) Ltd v Goede Hoop Sitrus (Pty) Ltd*,²⁶² reference may be had to previous judicial decisions (under the Companies Act 1926 and the Companies Act 1973) so as to resolve the construction and interpretation of s 163 of the Act.²⁶³ (Even though s 163 of the Act is more widely drafted than its forerunners to now include the unfair disregard of the applicant’s ‘interests’.²⁶⁴)

In *Aspek Pipe Co (Pty) Ltd v Mauerberger*²⁶⁵ Tebbutt AJ noted that ‘oppressive’ conduct, as then used in s 210 of the English Companies Act 1948:

[H]as been defined as ‘unjust or harsh or tyrannical’²⁶⁶...or ‘burdensome, harsh and wrongful’,²⁶⁷...or which ‘involves at least an element of lack of probity or fair dealing’²⁶⁸...or ‘a visible departure from the standards of fair dealing and a violation of the conditions of fair play on which every shareholder who entrusts his money to a company is entitled to rely’.²⁶⁹

However, later in his judgment, Tebbutt AJ rejected the notion that an applicant must establish ‘tyrannical conduct’ or ‘a tyrannical abuse of power’.²⁷⁰

It has been authoritatively held that the word ‘unfairly’ qualifies the term ‘prejudicial’ and implies that the conduct complained of must be ‘unreasonable’.²⁷¹ Thus, ‘although the act or omission of a company, or the conduct of its affairs, may be prejudicial, it may nevertheless not be unreasonable that this should be the case’.²⁷² This means, therefore, that the judicial interpretation of the notion of ‘unfairness’, as it arises from time to time, is critical., It has been held in English law, for example, that the concept ‘cuts across the distinction between acts that do and acts that do not infringe rights, and requires the court to have regard also to wide equitable consider-

²⁶¹ *Peel* supra note 256 para 43.

²⁶² *Visser Sitrus (Pty) Ltd* supra note 256 para 54.

²⁶³ The judiciary may also have regard to foreign case law, as is evident from s 5 of the Act.

²⁶⁴ *Visser Sitrus (Pty) Ltd* supra note 256 para 53.

²⁶⁵ 1968 (1) SA 517 (C).

²⁶⁶ See *Marshall v Marshall (Pty) Ltd* 1954 (3) SA 571 (N) at 580.

²⁶⁷ See *Scottish Co-operative Wholesale Society Ltd* supra note 254 at 71.

²⁶⁸ See *Elder v Elder & Watson Ltd* [1952] SC 49 at 60.

²⁶⁹ At 526. See also *Donaldson Investments (Pty) Ltd v Anglo-Transvaal Collieries Ltd* 1979 (3) SA 713 (W), affirmed on appeal 1980 (4) SA 204 (T) and on further appeal 1983 (3) SA 96 (A).

²⁷⁰ *Aspek Pipe Co Ltd* supra note 265 at 528. See also *Marsh v Odendaalsrus Cold Storages Ltd* 1963 (2) SA 263 (W).

²⁷¹ See, for example, *Garden Province Investments v Aleph (Pty) Ltd* 1979 (2) SA 525 (D) at 531.

²⁷² Henochsberg op cit note 256 at 567-74(4).

ations'.²⁷³ ('Equitable considerations', however, are more apposite when dealing with quasi-partnerships, because some form of personal relationship or personal dealings is required.²⁷⁴). Further, in Australia the word 'unfairness' is said to suggest 'an obligation to act equitably and impartially in the exercise of power and authority'.²⁷⁵ In South Africa, the Cape Provincial Division notably held in *Aspek Pipe Co (Pty) Ltd* that conduct would be unfair and thus that a person would be entitled to relief under the oppression remedy if:

[The applicant] establishes that the majority shareholders are using their greater voting power unfairly in order to prejudice [the applicant] or are acting in a manner which does not enable [the applicant] to enjoy a fair participation in the affairs of the company.²⁷⁶

It is important to take note that the test is whether the conduct complained of is unfair, not whether it is illegal,²⁷⁷ and that the motive underlying the relevant act or omission may be (not will be) of assistance to the courts in deciding whether the conduct complained of falls within the parameters of the oppression remedy.²⁷⁸

The introduction of the phrase 'or that unfairly disregards the interests of' the applicant is noteworthy. The courts in Canada have interpreted the phrase 'unfairly disregard' as meaning 'to unjustly and without cause...pay no attention to, ignore or treat as of no importance the interests of security holders, creditors, directors or officers of a corporation'.²⁷⁹ Furthermore, the term 'interests', as used in s 163 of the Act, is wider and thus encompasses more than the word 'rights'.²⁸⁰

An important issue that remains is whether the different elements of the phrase 'has had a result that is oppressive or unfairly prejudicial to, or that unfairly disregards the interests of, the applicant' must be interpreted as comprising one composite whole or two distinct and alternative grounds for raising the oppression remedy (ie, whether the introduction of the words 'or that unfairly disregards the interests of'

²⁷³ Farouk HI Cassim et al op cit note 2 at 770 referring to *Re A Company (No 8699 of 1985)* [1986] BCLC 382; *Re A Company (No 00477 of 1986)* [1986] BCLC 376; *Re Saul D Harrison & Sons plc* [1995] 1 BCLC 14 (CA); *O'Neill v Phillips* [1999] 2 All ER 961 (HL).

²⁷⁴ *O'Neill v Phillips* ibid at 969; *Re Astec (BSR) plc* [1998] 2 BCLC 556 at 588.

²⁷⁵ *Re Alldrew Holdings Ltd v Nibro Holdings* (1993) 16 OR (3d) 718 (Gen Div) at 732. See also *Wayde v NSW Rugby League Ltd* (1985) 3 ACLC 799.

²⁷⁶ *Aspek Pipe Co Ltd* supra note 265 at 527.

²⁷⁷ Farouk HI Cassim et al op cit note 2 at 769-70.

²⁷⁸ *Ben-Tovim v Ben Tovim* 2001 (3) SA 1074 (C) at 1091.

²⁷⁹ *Stech v Davies* (1987) 53 Alta LR (2d) 373 at 379.

²⁸⁰ See, for example, *Utopia Vakansie-Oorde Bpk v Du Plessis* 1974 (3) SA 148 (A) at 163.

broadens the scope of s 163 of the Act). In *Peel*, a decision by the South Gauteng High Court in 2012, Moshidi J expressed a preference for the latter, thus concluding that, due to the incorporation of the aforementioned phrase, s 163 of the Act broadens the basis for the (common law) oppression remedy.²⁸¹ However, in *Visser Citrus (Pty) Ltd*, a decision by the Western Cape High Court in June 2014, Rogers J said the following:

I find it difficult to conceive of cases where the conduct complained of would be found to be ‘oppressive’ or as ‘unfairly disregarding the interests’ of the applicant without at the same time being ‘unfairly prejudicial’ to the applicant. In Australia a similar collection of phrases has been said to constitute ‘different aspects of the essential criterion, namely commercial unfairness’....So on this specific aspect I express my respectful disagreement with the observation of Moshidi J in para 53.1 in *Peel v Hamon J&C Engineering (Pty) Ltd* 2013 (2) SA 331 (GSJ) to the effect that the phrase ‘unfairly disregards the interests of’ the applicant indicates ‘a far wider basis upon which relief may be sought’. The old s 252 remedy, in keeping with equivalent provisions in Commonwealth jurisdictions, was not confined to the enforcement of ‘rights’ but covered ‘interests’ as well.²⁸²

7.4 Applying the statutory oppression remedy to triangular mergers

Before attempting to apply the statutory oppression remedy, it is important to emphasise that:

[I]t is not enough for an applicant to show that the conduct of which he complains is ‘prejudicial’ to him or that it ‘disregards’ his interests. The applicant must show that the prejudice or disregard has occurred ‘unfairly’. ‘Oppression’ likewise connotes an element at least of unfairness if not something worse.²⁸³

7.4.1 Illegal conduct

Where the conduct complained of is illegal as well as prejudicial to, or disregards the interests of, the applicant, it will in all probability also be unfair within the meaning of s 163 of the Act. As remarked by Rogers J in *Visser Citrus (Pty) Ltd*:

²⁸¹ *Peel* supra note 256 para 53.1.

²⁸² *Visser Citrus (Pty) Ltd* supra note 256 para 54.

²⁸³ *Ibid* para 55.

Where the impugned conduct is unlawful, and the conduct has a consequence that is prejudicial to the applicant, the prejudice to or disregard of the interests of the applicant is likely to be, perhaps invariably will be, ‘unfair’ within the meaning of s 163 [of the Act]. [Section 163 of the Act], like its forerunner, is thus available as a remedy for unlawful conduct.²⁸⁴

As explained in detail in Chapter 5, above, the impact of s 115(4) of the Act on the triangular merger structures as a means to effect business combinations in South Africa is significant. Whereas s 113(2) of the Act seemingly sanctions the use of the triangular merger structures, s 115(4) read with s 2 of the Act implies that, due to the statutory voting requirements, it is impossible for companies to lawfully effect such a transaction. Failing an exemption from the relevant statutory body, any use of the triangular merger structures ought to be considered illegal and therefore a court should be more inclined to find in favour of a minority shareholder – provided the conduct was also prejudicial to the shareholder (see in this regard Chapter 3.7 above). Also, bear in mind the retrospective nature of the oppression remedy.

7.4.2 Legal conduct

As observed in *Visser Citrus (Pty) Ltd*, the application of s 163 of the Act becomes ‘more difficult where the conduct complained of is lawful, ie within the powers of the relevant organ of the company...or within the power of the relevant official’.²⁸⁵ The difficulty referred to is mainly as a result of the principle of majority rule, which makes it clear that by becoming a shareholder in a company a person accepts to be bound by the legitimate decisions of the majority shareholders.²⁸⁶ As Rogers J concisely stated:

[A] South African court should...take the principle of majority rule and the binding nature of the company’s constitution as a starting point. In *Sammel & Others v President Brand Gold Mining Co Ltd* 1969 (3) SA 629 (A) Trollip JA said that ‘the principle of the supremacy of the majority is essential to the proper functioning of companies’...Where matters are left by the constitution to the judgment of the general meeting or the directors, and the shareholders or directors as the case may be have exercised the power within the parameters of

²⁸⁴ Ibid para 56.

²⁸⁵ *Visser Citrus (Pty) Ltd* supra note 256 para 56.

²⁸⁶ See, for example, *Sammel* supra note 12 at 678 (as quoted in Chapter 2.1 above); *Louw v Nel* 2011 (2) SA 172 (SCA) para 22.

any express or implied limitations, a court should be weary of substituting its own business judgment for that of the persons entrusted with the decision by the corporate statute.²⁸⁷

Consequently, provided that the company acted bona fide,²⁸⁸ a minority shareholder cannot obtain relief merely because he or she or it is outvoted, or on the basis that he or she or it has lost confidence in or is dissatisfied with the conduct of the affairs of the company. Instead, the shareholder must show that the act or omission is not only prejudicial to or disregards his or her or its rights or interests but also that it is unfairly so.²⁸⁹

Now, assuming that the triangular merger structures are indeed legal (or the implication of s 115(4) of the Act is overlooked) and the objective behind the transaction was to circumvent the voting and appraisal rights of the company's shareholders, can a disgruntled minority shareholder of the holding company rely on s 163 of the Act to challenge the fairness of the transaction and obtain the fair value for his or her or its shares? This is possible in theory. In *Aspek Pipe Co (Pty) Ltd* (a decision pertaining to s 111bis of the Companies Act 1926) the court indicated a willingness to intervene whenever the circumstances show that 'the majority shareholders are using their greater voting power unfairly in order to prejudice' a minority shareholder or 'are acting in a manner which does not enable [the minority shareholder] to enjoy a fair participation in the affairs of the company',²⁹⁰ (see the full quotation in Chapter 7.3 above). In other words, the applicant shareholder must prove that the aim behind the conduct complained of was to prejudice him or her or it (and that it did), or that the company intended to deprive him or her or it of its right to partake in the affairs of the company (and that it did). If, therefore, the company implemented a triangular merger with the sole purpose to deprive its minority shareholders of their voting and appraisal rights – rights which are extended to shareholders in general and, more importantly, to the shareholder in question – the conduct may well be deemed to amount to unfairly prejudicial or oppressive conduct within the meaning of s 163 of the Act.

²⁸⁷ *Visser Citrus (Pty) Ltd* supra note 256 para 64.

²⁸⁸ See s 76 of the Act; *Visser Citrus (Pty) Ltd* ibid para 58.

²⁸⁹ Farouk HI Cassim et al op cit note 2 at 772. See also *Aspek Pipe Co Ltd* supra note 265 at 527; *Donaldson Investments (Pty) Ltd* (1979 (3) SA 713 (W)) supra note 269 at 719.

²⁹⁰ *Aspek Pipe Co Ltd* supra note 265 at 527.

The difficulty lies in corroborating the above. If the company settled on the particular triangular merger structure for any reason other than to circumvent the voting and appraisal rights of the applicant shareholder (which is indeed possible, see Chapter 3.6 above), then the company's conduct will in all likelihood be deemed bona fide, and within the power of the majority shareholders and, therefore, the applicant minority shareholder ought to fail in his or her or its attempt to prove that the incongruous conduct was unfair.

7.5 Conclusion

Although the oppression remedy is considered to be 'the broadest, most comprehensive and most open-ended shareholder remedy in the common law world',²⁹¹ it does have its limitations. In the context of the triangular merger structures, the following is particularly evident. First, a recalcitrant shareholder can rely only on s 163 of the Act after the merger has been implemented. Stated differently, a shareholder cannot rely on the oppression remedy to prevent the implementation of the planned transaction. Nonetheless, if the shareholder's goal is only to withdraw from the company and receive the fair value for his or her or its shares, then this will not be of any significant consequence. Secondly, the principle of majority rule represents a major stumbling block for disgruntled shareholders. As was recently noted by Rogers J, a court should be wary of substituting its own business judgment for that of the persons entrusted with the affairs of the company.²⁹² What is more, the courts are not obliged to consider the underlying motive of the company.

As stated at the outset of this dissertation, the purpose of this chapter is to provide a brief overview of the oppression remedy. From what has been discussed, however, it is evident that an applicant under s 163 of the Act must allege and prove that the conduct complained of was unfair. Notably, there are no set guidelines to assist a court in this regard; instead, the judiciary is left to determine the unfairness (or fairness) of an act or omission on an ad hoc basis. However, as is evident from the decisions in *Peel and Visser Citrus (Pty) Ltd* (pertaining to the scope of the oppression remedy), the judiciary's interpretation of s 163 of the Act may vary in the extreme. As the aforementioned judgments are conflicting decisions by the High

²⁹¹ Stanley M Beck, 'Minority shareholders' rights in the 1980s' *Law Society of Upper Canada Special Lectures* (1982) at 311-12, quoted in James C Tory 'The oppression remedy: Reasonable expectations and the judicial role in corporate law' available at <http://www.torys.com>, accessed on 13 August 2014.

²⁹² *Visser Citrus (Pty) Ltd* supra note 256 para 64.

Court, clarity – by way of the Supreme Court of Appeal – will likely be needed to finally resolve the issue.

Also, as South Africa's courts have yet to decide whether the oppression remedy can be used to challenge the fairness of the triangular merger structures (and since the use of the triangular merger structures is potentially barred by s 115(4) of the Act), it is difficult to predict the outcome of such an application. Perhaps the oppression remedy will best be employed as an alternative to those remedies discussed in Chapter 4 (lifting the corporate veil) and Chapter 5 (the provisions of s 115(4) of the Act), above, ie as a fall-back or catch-all ground for challenging the triangular merger structures.

8. CONCLUSION

Due to the strategic nature of some commercial transactions, constituent parties are often required to test the limits of corporate statutes in order to attain the best and most profitable deal. This is especially true for corporate amalgamations or mergers. Mindful of the commercial realities and the need to readily integrate corporate change and restructurings, the Act provides companies with a modern, efficient and cost-effective method for effecting an amalgamation or merger. Companies can thus implement an amalgamation or merger without court approval or the unanimous consent of its shareholders. Instead, all that is required is the approval of the requisite number of shareholders (more specifically, those shareholders whose shares afford them the right to vote), which can be as low as 18.75 per cent. In return, dissenting minority shareholders are afforded the opportunity to opt out of the company through the exercise of their appraisal rights. Yet the right of appraisal – which paved the way for the incorporation of a statutory amalgamation or merger that is based on the basic principle of majority rule – can be circumvented by the use of an acquisition vehicle, or, stated differently, the use of the triangular merger structures.

As noted in *Dadoo*, companies are at liberty to take full advantage of the full legal framework so as to structure their affairs in a manner that best meet their particular needs, including making use of the separate legal personality of a subsidiary company or companies. All dealings, including the use of subsidiary companies, must, however, still take place within the parameters of the law. As was recently confirmed in *Ex Parte Gore*, if the corporate form is abused or thwarted in a manner that should

reasonably not be countenanced, a court of law should have regard to the substance of the transaction and, provided the facts support such a conclusion, order that the legal persona of the company in question be set aside. If, therefore, the separate legal personality of an insignificant subsidiary company is used by its holding company with the intention to circumvent the voting and appraisal rights of the latter's minority shareholders (rights which the said shareholders would be entitled to except for the incorporation and use of the shell subsidiary company as an acquisition vehicle), the law ought to recognise the transaction for what it is. It is, after all, an attempt by the holding company to subvert the voting and appraisal rights of its shareholders. In such instances the subsidiary company is subject to the exclusive and absolute control of the holding company and is used exclusively as a device or stratagem to circumvent the voting and appraisal rights of the holding company's shareholders – and for nothing else than to avoid an unwanted corporate expense.

Even if the foregoing legal argument is dismissed, s 115(4) of the Act ought to afford dissenting shareholders with a statutory basis to successfully challenge the implementation of a triangular merger. This is because the aforementioned provision excludes the only shareholder (CoH) of one of the recognised constituent parties (CoS) from the voting process, thus effectively prohibiting the triangular merger structures. This ambiguity, it is submitted, ought to be resolved through legislative amendment, not judicial interpretation. The legislator should take this opportunity to unambiguously state its intention with regard to the use of the triangular merger structures as an acceptable form of effecting business combinations – before the discrepancy is challenged in a court of law and the South African judiciary becomes embroiled in a debate similar to what took place in the US with regard to the *de facto* merger doctrine.

Disgruntled shareholders could, in addition to ss 20(9) and 115(4) of the Act, potentially also rely on s 163 of the Act so as to obtain the fair value of their shares; but not to prevent the implementation of a triangular merger. As remarked earlier, the oppression remedy is, however, probably best suited as an alternative ground (ie a plea in the alternative) to s 20(9) and/or s 115(4) of the Act.

In a country where few shareholders participate in the democratic corporate process, and even fewer are fully aware of their rights, it does seem as if it will be a long time before the statutory amalgamation or merger provisions are challenged as

proposed herein. This, however, does not diminish the fact that serious discrepancies exist within the current legislative provisions – discrepancies which ought to be rectified before it becomes the pivot upon which a future case rests.

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