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# THE EFFECTIVENESS OF THE APPRAISAL RIGHT AS A FORM OF SHAREHOLDER PROTECTION

A

Minor LLM Dissertation

by

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

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# I INTRODUCTION

With the objects of facilitating the creation of business combinations, promoting flexibility and enhancing efficiency in the South African economy the legislature liberalised fundamental transaction policy under the Companies Act 71 of 2008 ('the Act'). Two of the leading reforms were: limiting the court's involvement in the approval of fundamental transactions to specified circumstances, and the introduction of the innovative American concept of amalgamations and mergers ('M&A'). The M&A device is a court-free procedure by which two or more companies ('merging companies'), along with their respective assets, liabilities and sometimes shareholders are combined into one or more surviving or newly formed companies: provided the transaction is approved by a special majority of shareholders. However, this policy liberalisation – especially the limitation of court involvement – makes minority shareholders particularly vulnerable to abuse and oppression by majority shareholders. The liberalisation of fundamental transaction policy essentially relinquishes the notion that shareholders possess a vested right in the form of their shareholding, and adopts a new approach that the interests of shareholders are held subject to the judgement of the collective majority.[1]

In cognisance of the potential unfairness this policy liberalisation might have upon minority shareholders the legislature introduced the appraisal remedy. It is a non-fault remedy that gives shareholders, who disapprove of certain fundamental transactions, the right to receive an amount, in cash, equivalent to the fair value of their shares, which may be judicially determined, from the company. Essentially the appraisal remedy acts as a counterweight to the policy liberalisation as it attempts to achieve an appropriate balance between: majority shareholders' need for efficiency and flexibility in the alteration and restructuring of their company in order to keep it abreast of rapid economic changes; and minority shareholders' need to be appropriately compensated for the alteration or termination of their investment. The appraisal remedy, in the absence of general court involvement, has become the

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

primary protective remedy for minority shareholders of companies involved in fundamental transactions.

The principal contention of this dissertation is that the appraisal remedy is ineffective as the primary protective remedy of minority shareholders in fundamental transactions. The remedy is ineffective for numerous reasons; however, it is predominantly due to the complexity that engulfs both the determination of fair value and the requirements of the perfection procedure (the procedure which must be complied with in order to successfully obtain appraisal pay-out). These complexities make a dissenting shareholder's pursuit of the remedy exorbitantly costly and time consuming, which derogates from the remedy's appeal. Furthermore, through use of the triangular merger structure, it is possible for merging companies to avoid or bypass completely the triggering of the shareholders' appraisal rights; consequently, in such circumstances, the remedy is totally ineffective and cannot accurately be regarded as a form of minority shareholder protection – let alone the primary form.

The appraisal remedy, although ineffective in its current form, has the potential to rise to the title of 'the primary protective remedy of minority shareholders': provided the complexity surrounding both the perfection procedure and the determination of fair value is simplified. Once simplified, the excessive cost and time implications shall be greatly reduced; accordingly making the remedy more accessible to minority shareholders and, hence, more effective as a form of shareholder protection. This shall give the remedy some weight in countering the liberalisation of fundamental transaction policy, which will ultimately draw a fairer balance between interests of minority and majority shareholders. Moreover, avoidance of the appraisal remedy, through the triangular merger structure, is not an insurmountable obstacle: disenfranchised shareholders may make effective use of the Act's anti-avoidance provision, or veil piercing remedy, to vanquish the avoidance and regain access to their appraisal remedy.

The dissertation is divided into eight parts. Part II deals with the history of the appraisal remedy in the USA and its close link to the M&A device. It also traces the evolution of the remedy from serving a *quid pro quo* and liquidity function to a minority shareholder protection function. Part III focuses on the underlying rationale for the introduction of the appraisal remedy into South African company law: the protection of minority shareholders from abuse and oppression by majority shareholders. Part IV looks at the perfection procedure contained in s 164 and indicates some areas of concern. In part V the perfection procedure's cost, time and complexity implications upon the effectiveness of the appraisal remedy are pointed out and recommendations are made. Part VI deals with the complexity surrounding the determination of fair value and its ramifications upon the appraisal remedy's effectiveness. In part VII the triangular merger structure is analysed as a form of appraisal avoidance and the anti-avoidance provision (s 6(1)) and statutory veil piercing remedy (s 20(9)) are evaluated as methods of overcoming appraisal avoidance.

## II THE HISTORY OF THE APPRAISAL REMEDY AND ITS PURPOSES

Since the appraisal remedy is an entirely new concept to South African law it is imperative to look at its history, development and purpose(s) in order to come to a comprehensive understanding of it. This understanding shall form the foundation of this dissertation, as it provides a good indication of the purpose for which the remedy was introduced into South African law: minority shareholder protection. The effectiveness of the South African appraisal remedy, as a form of minority shareholder protection, can then be thoroughly analysed in the context of M&As.

Although the appraisal remedy has been part of US corporate law for over a century the exact purpose it serves remains uncertain and the role that it plays in modern corporate law remains elusive.[2] It is generally accepted that the remedy was introduced with a two-fold rationale: (1) it served as a *quid pro quo* for the loss of shareholders' right to veto fundamental corporate transactions after corporate statutes were amended to allow for *majority* shareholder approval thereof instead of *unanimous* shareholder approval; and (2) since minority shareholders no longer had the right to veto fundamental transactions it served a liquidity function, in the sense that it allowed dissenting shareholders a 'way out' of an investment that had been involuntarily altered by such a transaction.[3]

When the appraisal remedy was originally introduced fundamental transactions, particularly mergers, were engaged in by unrelated corporations and were structured so that shares in the acquiring corporation were issued as consideration to the shareholders of the target corporation; however, today cash is generally used as merger consideration, which permits the elimination or 'cashing out' of minority shareholders, in mergers between related corporations ('conflict of interest mergers').[4] In the USA merger transactions are commonly used solely for the purpose of eliminating minority shareholders. The change in the use of fundamental

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[2] Barry M Wertheimer 'The Purpose of the Shareholders' Appraisal Remedy' (1997-1998) 65 *Tennessee Law Review* 661 at 661-62.
[3] Ibid at 662-63.
[4] Ibid at 663.

corporate transactions requires a concomitant change in the deliberation about the purpose the appraisal remedy serves.[5]

Today it seems that the initial liquidity function attributed to appraisal rights has been superseded by a minority shareholder protection function, which predominately operates in the context of 'cash out' mergers between related corporations;[6] however, before expounding on this proposition it is first necessary to trace the historical roots of the appraisal remedy.

*(a) History of the appraisal remedy*

In the USA the first corporations were incorporated by specific legislative enactments that granted corporate charters. These corporate charters were typically granted to corporations that undertook business of a public nature (e.g. construction of railroads, toll roads, canals, bridges and mills), which would usually have been performed by the state.[7] The first general incorporation statute was adopted by the state of Connecticut in 1837; however, such statutes only became prevalent in the 1870s.[8]

The corporate charters were viewed as creating property and contract rights in the corporation's shareholders, both amongst the shareholders themselves and with the state; thus it was constitutionally impermissible for the state to alter such rights without the unanimous consent of all the shareholders.[9] Accordingly, the corporate charter could not be amended and fundamental corporate transactions could not be engaged in unless the shareholders unanimously assented thereto – this was known as the 'constitutional dilemma'. The requirement of unanimous consent led to a situation where a single shareholder could prevent a corporation from effecting an advantageous fundamental transaction. This was a significant

[5] Ibid.
[6] Ibid.
[7] Ibid at 664 see fn 11.
[8] Ibid see fn 13.
[9] Ibid see fn 14 & 15.

impediment to economic progress as it prevented corporations from effectively responding to the rapidly changing economic conditions of the time.[10]

The 'constitutional dilemma' was eventually resolved when the states began granting corporate charters that contained provisions reserving the states' power to amend the charters in the future.[11] If a state exercised this power, even without the unanimous consent of the shareholders, it was constitutionally licit since it was envisaged by, and did not derogate from, the original contract (i.e. corporate charter).[12] By the 1870s, when general incorporation statutes became prevalent, the practice of reserving the amendment power had become commonplace; thus unanimous shareholder assent to charter amendments was no longer constitutionally mandated.[13]

By the time most states had enacted general incorporation statutes the general rule still remained that a corporation could not engage in a fundamental transaction unless the shareholders thereof unanimously sanctioned the transaction.[14] As previously noted, this requirement was a significant impediment to economic progress since it permitted a single shareholder to veto/block a potentially advantageous fundamental transactions. This seemed unjust and contrary to the greater good.[15]

The judiciary began to derogate the unanimous approval requirement by, first, allowing majority approval for transactions involving a cash sale of all the assets of the corporation if it was insolvent and lacked prospects of profitability.[16] The use of majority approval was then further extended to: sales of assets for stock as opposed to cash; sales of the assets of corporations that were not yet insolvent but were in financial distress; and finally to the sale of assets of corporations that were not in financial distress.[17] At this point the sale of a corporation's assets could

[10] Ibid see fn 16.
[11] Ibid at 664-65 see fn 18.
[12] Ibid at 665 see fn 19.
[13] Ibid see fn 20.
[14] Ibid at 665.
[15] Ibid.
[16] Ibid see fn 24.
[17] Ibid at 665-66 see fn 25.

effectively be used as a substitute for a merger in order to avoid the requirement of unanimous approval.[18]

By derogating the unanimous approval requirement the judiciary also transformed the nature of the remedy available where fundamental corporate changes were effected without unanimous approval.[19] Initially the courts had granted aggrieved shareholders injunctions to prevent such transactions; however, they became more disinclined to do so and began granting aggrieved shareholders a *pro rata* share of the value of the corporation's assets.[20] Essentially, aggrieved shareholders were deprived of their right to prevent the transaction and retained only a claim for damages.[21] This was the appraisal right in its most primitive form.

The judicial-driven common law developments laid the foundation for the statutory resolution of the unanimous approval requirement. A multitude of states enacted statutes that permitted fundamental corporate transactions upon majority or supermajority approval.[22] Shareholders who objected to such transactions were granted the right to dissent and receive the fair value of their shares.[23] Today, in all the states across the USA, majority control of corporate decisions is the norm and so is the existence of some form of statutory appraisal remedy.[24]

*(b) Purposes of the appraisal remedy*

From a historical point of view it was generally accepted that the appraisal remedy was introduced with a two-fold rationale: (1) to compensate shareholders for the loss of the right to veto fundamental transactions after majority shareholder approval thereof was permitted instead of unanimous shareholder approval; and (2) to provide liquidity, or a 'way out', to shareholders who would otherwise be forced to remain in a corporation that was fundamentally different from the one they had initially



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[18] Ibid at 666 see fn 26.
[19] Ibid at 666.
[20] Ibid see fn 27-28.
[21] Ibid at 666.
[22] Ibid see fn 29.
[23] Ibid see fn 30.
[24] Ibid at 666.

invested in – this occurred when shareholders received illiquid shares in the merged corporation as merger consideration.[25]

A further explanation was that the appraisal remedy came about as a result of the ‘constitutional dilemma’; however, this ‘dilemma’ was resolved by the states reserving the power to make amendments to the charter in the future – this reserve of power was initially contained in the charters themselves and then in the general incorporation statutes.[26]

Professor Manning gives another explanation for the introduction of the appraisal remedy: it was not adopted with the purpose of protecting the minority, but rather to give greater control and freedom to the majority – i.e. to ‘free the majority from the tyranny of the minority’.[27] Without the appraisal remedy a dissenting shareholder’s only remedy was a court-sanctioned injunction, which would effectively prevent the majority endorsed fundamental transaction in question.[28] Accordingly, the appraisal remedy provided an alternative to an injunction, which permitted the will of the majority to prevail whilst compensating the shareholder for the alteration to his/her investment or loss of ownership thereof.[29]

Professor Manning stated that the purpose behind the introduction of the appraisal remedy accorded with the ‘general legal trend’ in American commercial law:

> ‘If one…surveys as a totality the pressure for the appraisal remedy, the judicial response to it, and the liberating effect the statutes have had upon management’s power, the whole sequence will be recognized as falling into the basic pattern that has characterized the evolution of American commercial law during the last one hundred years. We are all accustomed to observe…the rolling ground swell during this period from a law of fixity to a law of mobility, from a law centring on ownership to a law centring on claim, from a law focusing on the individual to a law



[25] Ibid at 667-68.
[26] Ibid at 668.
[27] Bayless Manning ‘The Shareholder’s Appraisal Remedy: An Essay for Frank Coker’ (1962-1963) 72 *Yale Law Journal* 223 at 228-30.
[28] Ibid.
[29] Ibid at 229-30.

> focusing on groups. The development of the appraisal remedy parallels the surge toward free transfer and assignability in every corner of American law…and the general tendency in the corporate field to centre within management all significant operational control, and to relegate the shareholder's claim of "ownership" to the status of a fungible dollar claim. For nearly a century, our law has been opting consistently for mobility and the will of the group. It no longer seems feasible (or, it is significant to note, moral) to permit the objecting individual to stand in the way of a transaction approved (or at least not objected to) by a majority (or those acting in their name). Probably the courts would have come to the support of the majority's mobility even without the appraisal statutes. The appraisal statutes are only a special legislative instance of a *general legal trend*. The appraisal statutes may be viewed either as a bulwark for the rights of the minority, or as a lubricant to speed the spread of majoritarianism. Of course the statutes might do both, depending upon their administration and their application.'[30]

These observations seem to have been correct as, in 1994, the American Law Institute's corporate governance project summarised US corporate law as a 'largely unqualified system of majoritarian control.'[31]

The historical rationales for the appraisal remedy are easily documented; however, over the years, various academics have expounded other useful purposes that the appraisal remedy might serve. Professors Kanda and Levmore opine that the most important purpose the appraisal remedy serves is the 'discovery purpose'.[32] They submit that the appraisal proceedings provide a method by which shareholders can discover, obtain redress for, and thereby prevent, wrongful behaviour by corporate managers (directors) in relation to the approval and structuring of a fundamental transaction that triggers the appraisal remedy.[33]

The 'discovery purpose' certainly has an appeal about it, as it is fairly easy to initiate since wrongdoing need not be pleaded.[34] Once the appraisal proceedings are initiated they may be used to ascertain (or 'discover') the 'fair value' of the



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[30] Ibid.
[31] American Law Institute 'Principles of Corporate Governance: Analysis and Recommendations' (1994) Part VII at 291.
[32] Wertheimer op cit note 2 at 671 see fn 52.
[33] Ibid at 671.
[34] Ibid at 672.

corporation, and in so doing corporate wrongdoing may be uncovered.[35] Should wrongdoing be discovered the aggrieved shareholder might seek redress for such wrongdoing;[36] however, this may be difficult because the initiation of appraisal proceedings results in the revocation of all the dissenting shareholder's rights – besides the right to be paid fair value. Nevertheless the 'discovery purpose', by focussing on the proceedings instead of the outcome, promotes the larger object of minority shareholder protection.[37]

In a similar vein, Professor Fischel views the appraisal remedy as an *ex ante* check on corporate managers who engage in transactions that appropriate corporate value to themselves, at the expense of outside shareholders, through conflict of interest transactions.[38] Such transactions are generally regulated by the fiduciary duties owed to the corporation by the directors; however, the appraisal remedy can also monitor these transactions by setting a 'reserve price' beneath which a director may not acquire the shares of a dissenting shareholder.[39] This approach operates *ex ante* in the sense that it gives minority shareholders the confidence that the value of their investment shall be protected; thus it encourages investment, which ultimately benefits all shareholders.[40] Moreover, the appraisal remedy operates as a check on corporate managers to structure any proposed transaction in an equitable manner so as to minimise the exercise of appraisal rights.[41]

Since the appraisal remedy was first adopted the nature of M&A transactions and their uses have transformed drastically.[42] Accordingly, these alterations must be taken into account when determing the modern day purpose of the appraisal remedy. Initially the remedy was adopted to serve a liquidity purpose. The 'market out exception'[43] animated the liquidity purpose: if the corporation's shares are publicly traded the liquidity purpose of the appraisal remedy shall be superfluous since the

[35] Ibid.
[36] Ibid.
[37] Ibid.
[38] Ibid at 673. Where an insider causes the corporation to engage in a fundamental transaction with another corporation they control.
[39] Ibid at 674 see fn 71 for opinion that 'market out exception' does not support the purpose of preventing insiders from appropriating corporate value.
[40] Ibid at 675.
[41] Ibid.
[42] Ibid at 676.
[43] See page 45 below for definition of 'market out exception'.

market itself provides the necessary liquidity.[44] In 1969 the 'market out exception' was made part of the American Model Business Corporation Act[45] ('MBCA'), but was deleted in 1978 in recognition of the fact that the predominate purpose of appraisal remedy had transformed along with the changed uses of mergers;[46] however, it was subsequently reinserted in 1999.

By the 1960s, with the recognition of cash as valid merger consideration, corporate management, backed by the majority of shareholders, began to use mergers solely as a vehicle to 'cash out' or eliminate minority shareholders.[47] Clearly liquidity was no longer minority shareholders' primary concern: they received cash and were not coerced into remaining in a corporation that had been intrinsically transformed; however, their main concern was the loss of ownership of their shares at neither the time nor the price of their choice.[48]

In 1995 Professor Thompson noted that eighty percent of recent appraisal cases in the USA involved 'cash out' mergers.[49] This indicates that the appraisal remedy now predominately serves as a check on 'the conflict of interest of those in control of the corporation who are setting terms at which the minority shareholders must exit'.[50] The shift to create a remedy that is directed towards conflict of interest, instead of liquidity, is further evidenced by the numerous amendments to the MBCA since 1978.[51] Professor Siegel similarly came to the conclusion that the primary purpose of the appraisal remedy of today is to provide shareholders a 'cash exit at fair value' – commonly in conflict of interest transaction that involve the eradication of minority shareholders by the majority – and to function as a check on majority shareholder behaviour.[52]

*(c) The underlying purpose of the appraisal remedy*

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[44] Wertheimer op cit note 2 at 677.
[45] Model Bus. Corp. Act (2008).
[46] Wertheimer op cit note 2 at 677.
[47] Ibid.
[48] Ibid at 677-78.
[49] Ibid at 678 see fn 93.
[50] Robert B Thompson 'The Case for Iterative Statutory Reform: Appraisal and the Model Business Corporation Act' (2011) 74 *Law & Contemporary Problems* 253 at 254.
[51] Ibid at 264.
[52] Wertheimer op cit note 2 at 678 see fn 95.

The various purposes served by the appraisal remedy may be summarised as follows:

> '(1) [T]o serve as a *quid pro quo* for the loss of the right to veto fundamental transactions; (2) to provide liquidity to keep shareholders from being locked into an investment in a corporation that has been fundamentally changed; (3) to remedy a potential constitutional problem with statutes that permit a majority of shareholders to decide whether to engage in a fundamental transaction; (4) to free the majority from the "tyranny of the minority"; (5) to further "discovery" of corporate wrongdoing in connection with the approval of a fundamental transaction; (6) viewed *ex ante*, to relieve shareholders from concerns arising out of…problems associated with the appropriation of corporate value by insiders; (7) to serve as a check on corporate managers; and (8) to assure that shareholders whose investments are terminated by a cash out merger receive fair value for their shares.'[53]

Despite differences in articulation a consistent principle underlies all – except purposes (4) and (5) – the above purposes: minority shareholder protection against the risk of corporate managers and majority shareholders appropriating corporate value to the minority's detriment.[54] Purposes (3) and (4) are not underpinned by this principle; however, in the case of purpose (4), there is no way of determining, with any certainty, whether the legislators adopted the appraisal remedy out of *bona fide* concern for minority shareholder protection[55] or as a pretence to enable majority shareholders to proceed with fundamental transactions unencumbered. [56] Essentially the one is the concomitant of the other[57] and, furthermore, freeing the majority from the tyranny of minority veto power is in no way antithetical to simultaneously protecting minority shareholders against majority abuse.[58] Notwithstanding the

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[53] Ibid at 679.
[54] Ibid.
[55] Ibid.
[56] Manning op cit note 27 at 228-30. However, see page 235, where it seems that Professor Manning implicitly acknowledged that the appraisal remedy was introduced to protect minority shareholders as he notes that '[u]nder most of the statutes, little or no thought has gone into the impact of the claims procedure upon the conduct of the corporate transaction'. This implies that appraisal statutes are drafted with the minority shareholder in mind and not the majority of the corporation.
[57] Wertheimer op cit note 2 at 679.
[58] Ibid at 680. Also see Manning op cit note 27 at 230 where Professor Manning stated: 'The appraisal statutes may be viewed either as a bulwark for the rights of the minority, or as a lubricant to speed the spread of majoritarianism. Of course the statutes might do *both*, depending upon their administration and their application.'

speculation as to the legislative intent, there can be no doubt that the actual manifestation thereof was to provide a statutory remedy to minority shareholders.[59]

What minority shareholders are being protected from can only be answered by recognising the changes that have occurred in M&A practice.[60] The original goal was to provide liquidity to shareholders who were trapped in an illiquid investment not of their making; however, recent US case law indicates that this is no longer the primary goal of the appraisal remedy.[61] Today the vast preponderance of appraisal cases deal with dissenting shareholders that have been 'cashed out' of their investment by majority shareholders; thus liquidity is not of concern to them since they receive liquidity in the form of cash consideration.[62] What concerns dissenting shareholders is the fairness of the fundamental transaction in question and, particularly, the fairness of the cash consideration received. Purposes (5) to (8) aim to address this concern.[63]

Consensus as to the rationale behind the appraisal remedy has been elusive; however, after the above consideration of the history and various purposes of the remedy it is patent that it is futile to attempt to ascribe a single rationale to the appraisal remedy.[64] It is clear that the remedy serves a multiplicity of purposes that are predominately predicated on the cardinal principle of minority shareholder protection in the event of fundamental corporate transactions.[65] Furthermore, although purposes (3) and (4) may not be predicated upon this cardinal principle it does not necessarily mean that they cannot co-exist since they are not diametrically opposed.



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[59] Wertheimer op cit note 2 at 679-80.
[60] Ibid at 680.
[61] Ibid.
[62] Ibid.
[63] Ibid.
[64] Ibid at 689.
[65] Ibid.

## III THE PURPOSE OF THE SOUTH AFRICAN APPRAISAL REMEDY

The history of the US appraisal remedy indicates that it is intrinsically linked to the M&A transaction; thus any attempt to determine the primary purpose served by the appraisal remedy must take into account the policy considerations underpinning M&As and the practical utilisation thereof. Thereafter it is clear that the primary purpose served by the remedy ultimately depends upon the practical utilisation of the M&A device.

Fundamental corporate transactions, including business combinations, have a broad impact upon society: they play an integral role in the efficient distribution of a society's resources and, accordingly, involve matters of public interest and policy.[66] Furthermore, fundamental transactions involve significant risk-taking and often, where listed companies are concerned, these decisions are not made by the shareholders themselves but by directors acting for their collective benefit.[67] It is thus imperative that fundamental corporate transactions are regulated in order to strike an appropriate balance between encouraging economic activity and protecting the interests of a company's shareholders, the economy and society at large.[68]

In order to achieve the primary objective of promoting flexibility and efficiency in the economy[69] the Companies Act seeks to facilitate business combinations[70] and 'to provide for equitable and efficient amalgamations, mergers and takeovers of companies'.[71] In pursuit of these objectives the Act extensively revised the regulatory regime for fundamental transactions, predominately through the introduction of the US concept of M&As.

M&As provide a straightforward, comprehensible and effective procedure that permits business combinations through a written agreement – without court

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[66] Ezra Davids, Trevor Norwitz and David Yullis 'A microscopic analysis of the new merger and amalgamation provision in the Companies Act 71 of 2008' (2010) *Acta Juridica: Modern Company Law for a Competitive South African Economy* 337.
[67] Ibid at 338.
[68] Ibid.
[69] Maleka Femida Cassim & Jacqueline Yeats 'Fundamental Transactions, Takeovers and Offers' in Farouk H I Cassim (managing ed) et al *Contemporary Company Law* 2 ed (2012) 672 at 675 see fn 2.
[70] Ibid see fn 1.
[71] Preamble to the Companies Act.

involvement unless specific circumstances arise[72] – which has been approved by special resolutions of the majority shareholders of all the merging companies.[73] The M&A device is the manifestation of the principle that majority rule suffices to fundamentally alter the nature of a company, as well as the nature of the shareholders' investment therein, without the need for court approval thereof.[74] The elimination of judicial sanction, as a general requirement for fundamental transactions, greatly facilitates business combinations, which assists companies in adapting to ever changing business conditions and, in turn, promotes wealth creation and economic growth.[75] However, the lack of general judicial involvement has the potential to make minority shareholders more susceptible to abuse and oppression by the majority.

In a traditional merger the assets and liabilities of two or more companies are pooled into a single company, which may be one of the existing companies ('surviving company') or a newly formed company ('new company'). The former situation results in the disappearing of one of the existing companies and the latter results in the disappearing of all the existing companies. Merger consideration is usually paid to shareholders of the disappearing company as recompense for their disappearing shares. Merger consideration may either take the form of shares in the new/surviving company or, since the permissible merger consideration is broadly defined in the Act, cash.[76]

The recognition of cash as valid merger consideration permits the 'cashing out' of shareholders – i.e. the compulsion of their disinvestment from the company in return for cash.[77] Thus merger consideration is of fundamental importance as it



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[72] Section 115(3)-(6).
[73] M F Cassim op cit note 69 at 677.
[74] M F Cassim op cit note 1 at 20.
[75] M F Cassim op cit note 69 at 677.
[76] Ibid at 687. Section 113(2)*(d)* read with the definition of 'consideration' in s 1:

> ' "consideration" means anything of value given and accepted in exchange for any property, service, act, omission or forbearance or any other thing of value, including –
>
> *(a)* *any money*, property, negotiable instrument, *securities*, investment credit facility, token or ticket;
>
> *(b)* any labour, barter or similar exchange of one thing for another; or
>
> *(c)* any other thing, undertaking, promise, agreement or assurance, irrespective of its apparent or intrinsic value, or whether it is transferred directly or indirectly.'

[77] M F Cassim op cit note 69 at 687.

greatly influences the practical utilisation of M&As, which effects the purpose served by the appraisal remedy.[78]

The introduction of M&As represents a significant policy liberalisation that favours the efficient facilitation of business combinations, in the interests of economic growth, over shareholder interests in the retention of their investments and the protection of minority shareholders from majority oppression.[79] This liberal shift in corporate policy is akin to US commercial law's preference for majority control.[80]

The new policy approach is in stark contrast to South Africa's general adherence to English company law whereby shares have traditionally been recognised as proprietary rights, which shareholders ought to be able to retain without the risk of mandatory disinvestment; however, such rights are not absolute.[81] The proprietary nature of shares is diminished by the permissibility of cash as merger consideration: it allows the 'cashing out' or expropriating of minority shareholders' investments.[82]

Under the old Companies Act[83] shareholders, in the context of expropriation by scheme of arrangement under s 311, had the right to insist on remaining a shareholder of a company and could thus not be compelled to disinvest; however, under the liberal approach this is no longer the case as it essentially

> 'abandons the idea that shareholders possess "vested rights" in the form of their investment, and instead establishes the new approach that "shareholder interests are held subject to the exercise of collective shareholder judgment"'.[84]

The policy liberalisation in favour of majority rule raises questions about the protection of minority shareholders who dissent from majority endorsed fundamental transactions. This is where the appraisal remedy becomes important, as it



[78] Ibid at 686.
[79] Ibid at 677.
[80] As noted by Professor Manning in 1962. See pages 8-9 above.
[81] M F Cassim op cit note 1 at 21.
[82] Ibid at 20-1.
[83] 61 of 1973.
[84] M F Cassim op cit note 1 at 21-2.

counterpoises the policy liberalisation by allowing dissenting minority shareholders to withdraw the fair value of their shares – in cash – on the occurrence of certain triggering events.[85] There are two equally important conflicting values in issue here: (1) the need to provide flexibility to the majority shareholders to enable them to fundamentally alter and restructure the company in order to keep it abreast of rapid economic changes; and (2) the need for minority shareholders to be able to retain their investment in the company along with their initial expectations of the fundamental nature of the company.[86] The concomitant introduction of M&As and the appraisal remedy reveals the legislature's desire to balance the rights and interests of minority shareholders with those of the majority.[87]

The appraisal remedy is a no-fault remedy that gives dissenting shareholders the right to have their shares bought by the company in cash, at a fair value, which may be judicially determined in certain circumstances.[88] Since dissenting minority shareholders have no general recourse to the courts, to prevent a duly and properly approved fundamental transaction, their primary recourse has become the appraisal remedy.[89]

The appraisal remedy is not a general right, as it is only triggered on the occurrence of certain triggering events contained in s 164(2): certain amendments to the company's Memorandum of Incorporation that are materially adverse to the rights or interests of shareholders of a certain class; disposals of all or the greater part of assets or undertaking of a company; M&A transactions; and schemes of arrangement. The grant of the appraisal remedy in these limited events recognises that they have significant and far-reaching effects for shareholders.[90] As noted above, such events may drastically transform the essence of the company and, in turn, the shareholders' rights therein.[91]



[85] M F Cassim op cit note 69 at 677.
[86] Maleka Femida Cassim 'Shareholder Remedies and Minority Protection' in Farouk H I Cassim (managing ed) et al *Contemporary Company Law* 2 ed (2012) 755 at 769.
[87] Ibid at 770.
[88] Ibid at 796.
[89] Ibid at 678.
[90] Ibid at 796.
[91] Ibid.

The South African appraisal remedy has three important underpinning objects. First, where the merger consideration takes the form of shares in the newly merged company, it provides liquidity in the form of a cash pay out – at fair value – by the company; thus, it operates as an 'exit mechanism' for shareholders who dissented from the merger.[92] It prevents a dissenting shareholder from being locked into an essentially new company in which the shareholder has no desire to invest.[93] It is opined that if M&As are predominately used to 'cash-out' minority shareholders, as it is in the USA, the liquidity purpose shall not be the primary purpose served by the appraisal remedy.

Secondly, the appraisal remedy may operate as a restraint or deterrent on bad business judgements made by directors: the greater the number of appraisal claims the more likely the board is to reconsider its decision.[94] Directors will certainly pay heed to the number of appraisal claims since appraisal pay-outs may have a severe economic impact on a company undergoing a merger, as they may drain the company's cash reserves at a time when liquidity is essential.[95]

Thirdly, and most importantly, the appraisal remedy operates as a 'vital remedy for unfairness' since it gives dissenting shareholders the right to judicially challenge the adequacy and fairness of the value of the merger consideration received for their shares.[96] Eighty percent of American appraisal litigation, as of 1995, related to the adequacy of the merger consideration received by dissenting shareholders.[97] As a subset of this purpose the appraisal remedy also operates as a check on opportunistic directors who structure fundamental transactions in a manner that appropriates corporate value to themselves, or a party related to them, to the detriment of minority shareholders – i.e. in addition to the fiduciary duties imposed on directors it provides a further remedy in conflict of interest transactions.[98]



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[92] Ibid at 770.
[93] Ibid.
[94] Ibid at 797.
[95] Manning op cit note 27 at 227-34.
[96] M F Cassim op cit note 86 at 797.
[97] Wertheimer op cit note 2 at 678 see fn 93.
[98] Ibid at 675; M F Cassim op cit note 86 at 797.

The simultaneous introduction of M&As and the appraisal remedy indicate that these two concepts are closely related; accordingly, the regulatory emphasis of the Act is on attaining an appropriate balance between the interests of all the shareholders: avoiding both majority oppression of the minority and minority obstruction of beneficial fundamental transactions.[99] Although the appraisal remedy serves a variety of purposes, all underpinned by the principle of minority shareholder protection, its primary purpose will ultimately depend upon the practical utilisation of the M&A device. It shall generally operate as a 'vital remedy for unfairness' in fundamental transactions.



[99] M F Cassim op cit note 69 at 677.

## IV THE SOUTH AFRICAN APPRAISAL REMEDY'S PROCEDURE

The appraisal remedy is not a general shareholder remedy, as it is only triggered on the occurrence of certain triggering events contained in s 164(2). These events are limited to: amendments to the company's Memorandum of Incorporation that are materially adverse to the rights or interests of shareholders of a certain class; disposals of all or the greater part of assets or undertaking of a company; M&A transactions; and schemes of arrangement. Since M&As and the appraisal remedy are intrinsically linked this dissertation uses M&As as the default triggering action.

In order for dissenting shareholders to acquire the right to demand that the company pay them the fair value of their shares, on the occurrence of a trigger event, the Act lays down a complex appraisal procedure to be complied with. Once dissenting shareholders have complied with these steps they are said to have 'perfected' their appraisal rights and are entitled to the fair value of their shares.[100] The necessary steps to perfect the appraisal right are considered below.

### *(a) Statement of appraisal rights*

When a company gives notice to shareholders of a meeting to consider adopting a resolution to initiate a triggering event that notice must contain a statement informing shareholders of their rights under s 164.[101] Section 113(5)*(b)* requires this notice to include 'a copy or summary of the provisions of… s 164 in a manner that satisfies prescribed standards'. Since there is no 'prescribed standard' the copy or summary must be in 'plain language' as defined in s 6(5).[102] A 'copy or summary' of s 164 alone will not satisfy the definition of 'plain language'; hence it will most likely constitute a material defect as contemplated in s 62(4) and (5) and will have to be ratified accordingly.[103]

### *(b) Notice of objection by dissenting shareholders*

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[100] M F Cassim op cit note 86 at 797.
[101] Section 164(2)*(b)*.
[102] Section 6(4)*(b)*.
[103] 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 180-1.

According to s 164(3) a dissenting shareholder *may* give the company written notice objecting to the merger resolution provided it is given at any time prior to the vote upon the resolution. Although this section is permissive – as evidenced by the use of 'may' – it constitutes an essential prerequisite for the exercise of the appraisal remedy: s 164(5)*(a)*(i) *requires* the dissenting shareholder to have sent notice of objection in order to be entitled to make a demand for the fair value of shares.[104] Dissenting shareholders are thus advised to comply with s 164(3) as soon as they are made aware of a merger resolution.

The object of this provision, in light of the potential cash drain attendant upon appraisal demands, is to alert the company as to the number of dissenters so that it may estimate the amount of cash payment required upon appraisal.[105] If a large number of shareholders are intending to dissent the board may reconsider the merger decision before putting it to a special resolution – even after a resolution has been adopted s 164(9)*(c)* makes express provision for the possibility that it may subsequently be revoked.[106]

Section 164(6) permits two exceptions to the notice requirement: if the company failed to include a statement of the shareholders' appraisal rights in the notice of the meeting or if the company failed to give notice of the meeting at all. If the statement of the appraisal remedy is made but does not satisfy the definition of 'plain language' in s 6(5) it will be defective and, consequently, constitute a failure to include a statement of s 164 rights; thus giving rise to a valid exception in terms of s 164(6).

*(c) Notice of adoption of resolution*

Section 164(4) requires the company, within ten business days after the adoption of the merger resolution, to send notice of the adoption to each shareholder who gave

[104] This is further emphasised by s 115(8)*(a)*: 'The holder of any voting rights in a company is entitled to seek relief in terms of section 164 if that person…notified the company in advance of the intention to oppose a special resolution contemplated in this section… .'
[105] M F Cassim op cit note 86 at 800.
[106] Ibid.

written notice of objection and who has not withdrawn that notice nor voted in support of the resolution. If the company fails to provide such notice it suffers no adverse legal consequences in terms of the Act.[107]

*(d) Demand by dissenting shareholder*

According to s 164(5) a shareholder may demand that the company pay the shareholder the fair value for all of the shares of the company held by that shareholder provided: *(a)* the shareholder sent the company a notice of objection – subject to the exceptions listed in s 164(6); *(b)* the company has adopted the contemplated resolution; and *(c)* the shareholder voted against that resolution and has complied with all of the procedural requirements of s 164. If a shareholder satisfies the above requirements he is entitled to demand that the company pay him the fair value for all his shares. By demanding payment the shareholder 'perfects' the appraisal right.[108]

M F Cassim notes that the 'no-appraisal threshold', which denied the appraisal remedy to minority shareholders if the resolution was adopted with more than 75 per cent of the voting shares, under the draft Companies Bill,[109] has been sensibly discarded: it was 'manifestly and strikingly inappropriate' in view of the underlying object of minority shareholder protection.[110] A 'no-appraisal threshold' draws the balance between the rights of majority shareholders, to effect a merger, and the rights of minority shareholders, to 'opt-out', too heavily in favour of the former as it denies the latter their primary protective remedy; thus a 'no-appraisal threshold' defeats the purpose of minority protection entirely.[111]

If one attributes Professor Manning's primary purpose to the appraisal remedy, to free majority shareholders from minority recalcitrance, the scrapping of the 'no-appraisal threshold' may not be so sensible.[112] The appraisal remedy has the

[107] Ibid at 801.
[108] Ibid at 802.
[109] GN 166 GG 29630 of 12 February 2007, cl 165(4)(*c*).
[110] M F Cassim op cit note 86 at 801.
[111] Maleka Femida Cassim 'The Introduction of the Statutory Merger in South African Corporate Law: Majority Rule Offset by the Appraisal Right (Part 2)' (2008) 20 *SA Merc LJ* 147 at 161.
[112] Manning op cit note 27 at 227-34.

potential to give dissenting minority shareholders disproportionate bargaining power to their number:

> 'Ninety per cent of the shareholders may have voted for the merger and the merging corporations may be economically sound, but if the market value of the shares is substantial, the corporation may not be able to find the cash to buy out the ten per cent of the shareholders who did not vote for the transaction and may have to pull out of the deal. In such a situation, the appraisal statutes have obviously failed in the job of providing simultaneously for a protection to the dissidents and an avenue of mobility for the majority.'[113]

Moreover, the minority's disproportionate bargaining power may be exacerbated further, as appraisal pay-outs may drain the company's cash reserves at a time when liquidity is essential: there is 'intense activity as a general reshuffling takes place in the administrative, productive, and distributional arrangements of the combined enterprises'.[114] Professor Manning submits that a 'no-appraisal threshold' solves the problem of disproportionate minority bargaining power.[115] Nevertheless, it is submitted that M F Cassim is correct, since the South African appraisal remedy is underpinned by the principle of minority shareholder protection and a 'no-appraisal threshold' has the arbitrary effect of denying the remedy to a small group of dissenters but allowing it to a large group of dissenters. This arbitrary effect defeats the very aim of the 'no-appraisal threshold' expounded by Professor Manning.

The appraisal remedy is granted only to shareholders who are entitled to vote on the relevant resolution; thus the appraisal remedy will not extend to shareholders who are debarred from voting on resolutions in terms of s 115(4),[116] nor to shareholders who do not hold any voting rights.[117]

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[113] Ibid at 236.

[114] Ibid at 234. Professor Manning gives an example of this 'intense activity': it would be desirable to cancel a lease on a now duplicate facility in order to save paying double rent, but the cancellation will cost an immediate penalty payment by the lessee to the lessor.

[115] Ibid at 236 see fn 31.

[116] Section 115(4):

> 'For the purposes of subsections (2) and (3), any voting rights controlled by an acquiring party, a person related to an acquiring party, or a person acting in concert with either of them, must not be included in calculating the percentage of voting rights –
>
> > *(a)* required to be present, or actually present, in determining whether the applicable quorum requirements are satisfied; or

A demand is made by delivering written notice to the company within 20 business days after receiving notice of the adoption of the resolution; or if the shareholder did not receive this notice, within 20 business days after learning that the resolution had been adopted.[118] Such a demand must state: the shareholder's name and address; the number and class of shares in respect of which the shareholder seeks payment; and a demand for payment of the 'fair value' of those shares.[119] This written demand must also be delivered to the Takeover Regulation Panel.[120]

According to s 164(9) a shareholder who has sent a demand in accordance with s 164(5) to (8) has no further rights in respect of those shares, other than to be paid their fair value. This accords with the approach that the shareholder has voluntarily elected to 'opt-out' of the company; hence the shareholder should lose its rights to future dividends and voting rights.[121] Notwithstanding, the shareholder's rights are reinstated without interruption in three circumstances: first, where a dissenter withdraws the demand before the company makes an offer, or allows the company's offer to lapse; secondly, where the company fails to make an offer and the shareholder withdraws the demand; and thirdly, in the event that the company revokes the adopted resolution that gave rise to the shareholder's appraisal right.[122]

Section 164(9) raises questions as to the precise ambit of the 'rights' lost: is a shareholder entitled to bring an action in terms of the oppression remedy (s 163) after his rights have been abrogated? It should be noted that s 184(11) of the Canada Business Corporations Act[123] was similarly worded to s 164(9) and (10); thus Canadian jurisprudence may be helpful in the resolution of this issue. Section 184(11) of the Canadian Act provided:

> 'After sending a notice…a dissenting shareholder ceases to have any rights as a shareholder except the right to be paid the fair value of his shares as determined

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> *(b)* required to be voted in support of a resolution, or actually voted in support of the resolution.'

117 M F Cassim op cit note 86 at 802.
118 Section 164(7).
119 Section 164(8).
120 Section 164(8).
121 M F Cassim op cit note 86 at 802.
122 Section 164(9) & (10).
123 S.C. 1974-75-76, c. 33.

> under this section, unless the dissenting shareholder withdraws his notice before the corporation makes an offer…in which case his rights as a shareholder are reinstated.'

In the Canadian case of *Brant Investments Ltd v Keeprite Inc,*[124] it was held that the appraisal remedy was a contingent remedy since the shareholder could withdraw his demand and retain his full rights as a shareholder; thus he did not lose his rights to the oppression remedy once he had submitted a demand, but only lost the usual rights to dividends and to vote. Whether this reasoning is apt in South Africa remains to be seen, but it is important to note that the appraisal remedy is also contingent under our Act.[125]



Section 164 does not specifically disallow partial dissent, but reference to '*all* of the shares of the company held by that person' in s 164(5) implies that a dissenting shareholder must demand the company purchase all of his shares, regardless of their class, and that partial dissent is not permissible.[126] This prevents shareholders from 'hedging their bets' by voting one class in favour of, and the other class against, a merger resolution. However, the s 164(8)*(b)* requirement that a shareholder must state 'the *number* and *class* of shares in respect of which the shareholder seeks payment' in the written appraisal demand, and the reference to '*those* shares' in s 164(9), implies that the legislature intended to permit partial dissent. Partial dissent may be appropriate when dealing with an alteration of class rights as contemplated by s 164(2)*(a)*, but it is submitted that for the purposes of mergers it is not, since all of a shareholder's shares, regardless of class, shall be effected by the merger transaction.

*(e) Offer by the company*

Once dissenting shareholders have made their demands the company must send to each shareholder, who has sent such a demand, a written offer to pay an amount considered by the company's directors to be the fair value of the relevant shares –

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[124] (1983) 44 OR (2d) 661 (Ont HC).
[125] Section 164(9)*(a)* to *(c)* and s 164(10).
[126] Beukes op cit note 103 at 184.

determined as at the date on which, and time immediately before, the company adopted the resolution that gave rise to the shareholders' appraisal rights – accompanied by a statement showing how that value was determined.[127] This offer must be sent within five business days after the later of: *(a)* the day on which the action approved by the resolution is effective; *(b)* the last day for the receipt of demands in terms of s 164(7)*(a)*; or *(c)* the day the company received a demand as contemplated in s 164(7)*(b)*.[128]

*(f) Shareholder's acceptance of the offer*

The dissenting shareholder may either accept or reject the offer. If he/she choses to accept, he/she must do so within 30 days after it was made or else the offer shall lapse.[129] If the offer lapses all the shareholder's rights in respect of the shares are reinstated.[130] If a shareholder accepts the offer:

> '*(a)* the shareholder must either in the case of –
>
> (i) shares evidenced by certificates, tender the relevant share certificates to the company or the company's transfer agent; or
>
> (ii) uncertificated shares, take the steps required in terms of section 53 to direct the transfer of those shares to the company or the company's transfer agent…'[131]

The company must pay that shareholder the agreed amount within ten business days after the shareholder accepted the offer and tendered the share certificates or directed the transfer to the company of uncertificated shares.[132]

What happens if the company neither pays a dissenting shareholder the agreed amount, nor applies to court for an order varying its obligations (see (*h*) below)? Provided the company failed to make an offer or the company made an inadequate offer the shareholder has the right to apply to court to determine the fair

[127] Section 164(11) and (16).
[128] Section 164(11).
[129] Section 164(12)*(b)*.
[130] Section 164(9) and (10).
[131] Section 164(13).
[132] Section 164(13)*(b)*.

value of his/her shares and for an order requiring the company to pay him/her the amount judicially determined; however, s 164 does not provide for a dissenting shareholder to apply to court if the company simply fails to pay the agreed amount.[133]

The shareholder will have to prove a valid contract, for the agreed amount, between the shareholder and the company.[134] The shareholder may then claim specific performance for *mora debitoris*. Section 164(13)*(b)* states that 'the company *must* pay that shareholder the agreed amount…'; thus if the company fails to pay the shareholder within ten business days it contravenes the Act. According to s 218(2) 'any person who *contravenes* any provision of this Act is liable to any other person for any loss or damage suffered by that person as a result of that contravention'. Accordingly, the company will be liable for any loss or damages suffered by the dissenting shareholder due to the company's failure to pay the shareholder the agreed amount within ten business days of him/her tendering his/her share certificate.

*(g) Court application by shareholder to determine fair value ('judicial appraisal')*

Section 164(14) provides that a shareholder who has made a demand may apply to a court for a determination of a fair value in respect of the shares that were the subject of that demand, and an order requiring the company to pay the shareholder the fair value so determined, if the company: failed to make an offer; or made an offer that the shareholder considers to be inadequate, and that offer has not lapsed. One observes that when the appraisal right is invoked, the involvement of the courts is not inevitable or automatic, in fact it may not occur at all.[135] On an application to the court all dissenting shareholders who have not accepted the offer from the company at the date of the application must be joined as parties and are bound by the decision of the court; the company must notify each affected dissenting shareholder of the date, place and consequences of the application and of their right to participate in the

[133] Beukes op cit note 103 at 190.
[134] Ibid.
[135] M F Cassim op cit note 86 at 805.

court proceedings; furthermore, the court may determine whether any other person is a dissenting shareholder who should be joined as a party.[136]

The court must determine the 'fair value', in respect of the shares of all the dissenting shareholders, as at the date on which, and time immediately before, the company adopted the resolution that gave rise to the shareholder's appraisal rights.[137] The Act is silent as to the meaning of 'fair value' and does not provide a method of evaluation;[138] however, the court is given the discretion to appoint one or more appraisers to assist it in determining the fair value.[139]

Besides determining the 'fair value' the court must also make an order: requiring the dissenting shareholders to either withdraw their respective demands or to take the necessary steps to transfer their shares to the company; and requiring the company to pay the fair value in respect of their shares to each dissenting shareholder who complies with necessary steps to transfer their shares to the company – subject to any conditions the court considers necessary to ensure that the company fulfils its obligations under s 164.[140]

It is not clear whether, in terms of the court order, the shareholder has a choice to withdraw its demand or tender its shares and accept the judicially determined fair value, or whether the court is entitled to make that decision.[141] The former interpretation is the more literal, but the latter is the most logical and reasonable.[142]

A further concern is that it is not clear what is meant by 'all of the shareholder's rights in respect of the shares are *reinstated* without interruption'.[143] In the merger context, it is submitted that it should mean: dissenting shareholders will be reinstated to their full rights to be treated like any other shareholder *under the*

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[136] Section 164(15)*(a)*, *(b)* and *(c)*(i).
[137] Section 164(15)*(c)*(ii); s 164(16).
[138] M F Cassim op cit note 86 at 805.
[139] Section 164(15)*(c)*(iii)(*aa*).
[140] Section 164(15)*(c)*(v).
[141] Davids op cit note 66 at 361.
[142] Ibid.
[143] Section 164(10).

*merger agreement* (including receiving cash or other consideration for their shares if that is what is provided for in the merger agreement), and not that such a shareholder is entitled to remain a shareholder in the company after the merger.[144] The latter interpretation would often be inconsistent with the intent of the merging parties to eliminate all minority shareholders and own 100 per cent of the target company.[145] It would also be inconsistent with the legislature's intention to provide for efficient and flexible mergers.

If s 164(15)*(c)*(v) is interpreted to give the dissenting shareholder a choice as to whether to withdraw its demand (and be reinstated) or to tender its shares (and receive judicially determined value), it would encourage shareholders to dissent from transactions and exercise appraisal rights on a 'no-lose' basis: shareholders could always withdraw their demand and receive the deal price if the judicially determined 'fair value' turns out to be less than they were originally offered.[146] If 'reinstatement' means the dissenter cannot be forced-out then the impact is exacerbated as the dissenting shareholder is given three options: stay in, obtain judicial fair value or take the offered price by dropping the court proceedings.[147] A possible mitigating factor is that the court may make a cost order that is adverse to the shareholder.[148] It is submitted that the Delaware model should be followed: a dissenting shareholder, who does not withdraw his/her request for appraisal and accept the deal price, *will* receive the judicially determined 'fair value'.[149]

Section 164(15A) gives dissenters a choice, at any time before the court has made a determination of fair value, to accept the company's offer of fair value. This is intended to promote settlement; however, it is also susceptible to abuse by shareholders.[150]



[144] Davids op cit note 66 at 362.
[145] Ibid. It will also defeat the purpose advocated by Manning: free the majority from minority recalcitrance.
[146] Ibid.
[147] Ibid. Probably not the intention of the Legislature when one looks at the availability of various merger structures and consideration as provided under s 113.
[148] Ibid.
[149] Ibid at 363.
[150] M F Cassim op cit note 86 at 806.

The Act permits the court to make an appropriate order of costs, having regard to any offer made by the company, and the final determination of the 'fair value' by the court.[151] The threat of an adverse cost order may act as a deterrent to shareholders. The court has the discretion to allow a reasonable rate of interest on the amount payable to each dissenting shareholder from the date the action approved by the resolution is effective until the date of payment.[152] The underlying purpose is to compensate the dissenting shareholder for the loss of the use of its funds during the appraisal period.[153]

*(h) Court application by company to vary obligations*

If there are reasonable grounds to believe that compliance by a company with a court order, or payment by the company of the agreed amount offered to dissenting shareholders, would result in the company being unable to pays its debts as they fall due and payable for the ensuing 12 months, the company may apply to a court for an order varying the company's obligations.[154] The court may make an order that: is just and equitable, having regard to the financial circumstances of the company; and ensures the person to whom the company owes money is paid at the earliest possible date compatible with the company satisfying its other financial obligations as they fall due and payable.[155]

It is submitted that the court should take the agreed amount into consideration when varying a company's obligations: when a dissenting shareholder accepts the company's offer a valid contract comes into existence, which implies the parties agree that the offer reflects a fair value.[156] Importantly, the court is not determining the fair value, but rather varying the company's exiting obligations in a just and equitable manner.



[151] Section 164(15)*(c)*(iv).
[152] Section 164(15)*(c)*(iii)(*bb*).
[153] M F Cassim op cit note 86 at 806.
[154] Section 164(17).
[155] Section 164(17).
[156] Beukes op cit note 103 at 192.

If a merger results in the relevant company ceasing to exist, the obligations of the company, under s 164, are the obligations of its successor resulting from the merger.[157]

[157] Section 164(18).

## V THE EFFECTIVENESS OF THE APPRAISAL REMEDY AS A FORM OF MINORITY SHAREHOLDER PROTECTION IN LIGHT OF THE COST, TIME AND COMPLEXITY IMPLICATIONS OF THE PERFECTION PROCEDURE

Section 164's procedure (the 'perfection procedure') plays a pivotal role in determining the effectiveness of the appraisal remedy as a form of minority shareholder protection in fundamental transactions, since its nature effectively determines shareholders' access to the appraisal pay-outs. If the procedure is cumbersome, costly and time-consuming dissenting shareholders will most likely opt for some other remedy or accept the terms of the merger agreement in spite of their unhappiness therewith; however, if the procedure makes the pursuit of appraisal easy and efficient dissenting shareholders shall embrace it as their remedy of choice.[158] Prior to analysing the South African perfection procedure, its role must be contextualised in relation to the introduction of the appraisal remedy and the liberalisation of fundamental transaction policy under the Act. In doing so it is worth noting the development of perfection procedures in the USA.

The perfection procedures in most US states are cumbersome, costly and time-consuming. At the time of the procedures' drafting the appraisal remedy served a liquidity function and there was great concern over the liquidity drain appraisal pay-outs might have upon the cash reserves of a company, which could, if enough appraisal claims were awarded at a high enough amount, effectively thwart a beneficial merger.[159] In an effort to prevent minority shareholders draining the company of its liquidity the appraisal statutes contained a series of strict procedural requirements that dissenting shareholders had to complete in order to 'perfect' their appraisal rights (receive cash pay-out for their shares).[160] In accordance with this purpose

> '[t]hese statutes were strictly construed so that if a shareholder missed one or more of these steps, the shareholder lost the right to appraisal and was relegated to the consideration specified in the merger [agreement]'.[161]

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[158] Manning op cit note 27 at 230.
[159] Ibid at 234.
[160] Thompson op cit note 50 at 255.
[161] Ibid.

With the introduction of cash as permissible merger consideration in the 1960s companies specifically began utilising M&As and their cash reserves to 'cash-out' minority shareholders; thus concern over the feared liquidity drain diminished. In simultaneity with the new use to which the M&A device was being put, the appraisal remedy's purpose changed from one aimed at providing liquidity to one aimed at protecting minority shareholders who had been 'cashed-out' of their investments on unfair terms; however, in spite of this 'fundamental shift' in the appraisal remedy's role, many state legislatures did not, and have still not, adapted the perfection procedure to accord therewith.[162] Consequently, the original perfection procedures' stringent and intricate requirements are often used by companies to ensure that a percentage of the minority shareholders do not pursue their appraisal rights and are left with the terms provided by the merger agreement, even if they are aggrieved by the terms thereof.[163] This greatly detracts from the protection provided by the appraisal remedy to minority shareholders.

Similarly to the perfection procedures in most American states the South African perfection procedure is cumbersome, costly and time-consuming.[164] This has the effect of favouring the interests of the company (majority shareholders) over those of minority shareholders, which seemingly indicates: (1) a conscious policy preference by the legislature favouring the facilitation of business combinations, in the interests of economic growth, over the protection of the value of minority shareholders' investments; and/or (2) a failure by the legislature, when looking for legislative guidance on the perfection procedure in the USA, to fully understand the fundamental shift that the appraisal remedy has undergone there.

The appraisal remedy was introduced as a counterweight to the liberalisation of fundamental transaction policy under the Act and, as a counterweight, it has the potential to outweigh, or derogate from, the intended consequences of the policy liberalisation (i.e. the company may be drained of liquidity to the extent that it is no longer economically feasible for it to go through with the fundamental transaction in

[162] Ibid at 254.
[163] Ibid at 258.
[164] M F Cassim op cit note 86 at 807; Davids op cit note 66 at 360.

question). Accordingly the legislature made the perfection procedure cumbersome, costly and time-consuming, in order to discourage dissenting shareholders from claiming appraisal and hampering efficient fundamental transactions. If this was the legislature's intention it failed (like many of the state legislatures in the USA) to recognise that, in practice, most companies use the M&A device and their cash reserves – effectively nullifying the liquidity drain concern – to 'cash-out' minority shareholders on unfair terms. This failure hampers shareholder access to the remedy and effectively makes it easier for a company to 'cash-out' its minority shareholders on terms favourable to the company. This derogates from the appraisal remedy's effectiveness as a form of minority shareholder protection and gives the remedy a feather's weight in counterbalancing the liberalisation of fundamental transaction policy – drastically tipping the scales in favour of the company over minority shareholders' interests.

M F Cassim goes so far as to submit that the entire perfection procedure is 'skewed in favour of the company' and that the inherent imbalance 'operates in favour of the company and harshly against shareholders'.[165] It is submitted that as the perfection procedure currently stands it does not achieve an appropriate balance between the interests of the company and the minority shareholders thereof, particularly in light of the minority shareholder protection rationale behind the appraisal remedy.

The perfection procedure should be viewed as a balancing mechanism (a scale) that attempts to balance the liberalisation of fundamental transaction policy, which favours the facilitation of efficient business combinations through majority shareholder control, against the appraisal remedy's principal purpose of protecting minority shareholders from being 'cashed-out' of their investment on unfair terms set by the majority. The perfection procedure, viewed as a balancing mechanism, is analysed below and recommendations on how to improve it, in order to enhance the effectiveness of the appraisal remedy as the primary form of minority shareholder protection, are submitted.



[165] M F Cassim op cit note 86 at 807-8.

The perfection procedure is cumbersome in the sense that it contains many complexities and technicalities relating to specific notices and prescribed time limits. The prescribed notices are aimed at ensuring that the corporation is informed, at an early stage, of the number of shareholders who will seek appraisal: in light of the potential liquidity drain appraisal claims might have on the company, the corporate controllers (directors and majority shareholders) have a legitimate interest in knowing how many shareholders will claim appraisal in order to check the economic feasibility of the transaction.[166] The time limitations provide a timetable to keep the appraisal process moving and prevent undue delay to the implementation of the transaction in question.[167]

It is extremely difficult for a layperson to understand and comply with these procedural technicalities; nevertheless the Act requires meticulous compliance therewith and anything short thereof results in forfeiture of the appraisal right.[168] Accordingly the procurement of legal assistance, at the attendant cost, is absolutely imperative to a shareholder's chances of successful appraisal pay-out. In stark contrast the company suffers no adverse consequences if it fails to comply with the procedure. This inherent imbalance in the perfection procedure is particularly inappropriate in light of the fact that companies will generally have access to funds and, accordingly, legal assistance to ensure proper compliance, whereas minority shareholders generally do not, which may result in loss of the appraisal remedy due to an unwitting failure to comply with one of the requisite steps.[169]

Although the underlying purpose of the perfection procedure is to encourage and promote settlement between dissenting shareholders and the company, without the further delay and cost of judicial appraisal, it draws the balance between them too far in favour of the latter; thus hampering the effectiveness of the appraisal remedy.[170] It is submitted that a more appropriate balance might be drawn through

[166] Barry M Wertheimer 'The Shareholders' Appraisal Remedy and How Courts Determine Fair Value' (1998) 47 *Duke Law Journal* 613 at 708-9.
[167] Ibid.
[168] M F Cassim op cit note 86 at 807. See s 164(5)*(c)*(ii), which requires that a shareholder comply with all the procedural requirements of s 164 in order to be eligible to claim the fair value of his shares.
[169] Ibid at 808.
[170] Ibid.

the introduction of a ‘substantial compliance defence’ or ‘harmless error rule’.[171] This defence or rule allows a shareholder to perfect his appraisal right even if he does not strictly adhere to the perfection procedure: provided his deviation therefrom is insignificant and there has been no prejudice to the company as a result thereof.[172] This draws a fairer balance, as it still serves the above purposes whilst not denying the dissenting shareholder his appraisal right where he has made a harmless error in a genuine attempt to comply. In the meantime courts should adopt a flexible and lenient approach to dissenting shareholders who fail to comply.[173] The introduction of such a defence/rule shall greatly add to the effectiveness of the appraisal remedy as a form of minority shareholder protection.[174]

Another problem is that once a shareholder demands the fair value of his shares he loses all further rights in respect of those shares, other than to be paid their fair value.[175] Should the shareholder opt for judicial appraisal, in terms of s 164(14), he is only paid at the end of those proceedings;[176] thus the shareholder’s investment is frozen until the end of the judicial appraisal proceedings and he is effectively deprived of the use of his funds.[177] Accordingly, the shareholder may not finance his appraisal litigation, which creates pressure on the shareholder to settle for the amount offered by the company instead of pursuing judicial appraisal.[178]

Under the MBCA the company is required to effect a prepayment of the ‘undisputed fair value’ (i.e. the amount the company offers as ‘fair value’ for the shares) when the shareholder tenders his shares to the company.[179] In the comment to the MBCA the following rationale is given for the prepayment requirement:

[171] Wertheimer op cit note 166 at 709.
[172] Ibid.
[173] M F Cassim op cit note 86 at 808.
[174] It is worth noting that the notion of substantial compliance has been introduced into the new Companies Act under s 6(8)*(a)* & *(b)*. According to this provision if a form of a document, record, statement or notice is prescribed by the Act it is sufficient that the document, record, statement or notice satisfies the ‘substantive requirements of the prescribed form’.
[175] Section 164(9).
[176] Section 164(15)*(c)*(v)*(bb)*.
[177] M F Cassim op cit note 86 at 808.
[178] Mary Siegel ‘An Appraisal of the Model Business Corporation Act’s Appraisal Rights Provisions’ (2011) 74 *Law and Contemporary Problems* 231 at 236.
[179] Ibid at 235.

> 'Since…all rights as a shareholder are terminated with the deposit of that shareholder's shares, the former shareholder should have immediate use of such money. A difference of opinion over the total amount to be paid should not delay payment of the amount that is undisputed.'[180]

Prepayment has two practical effects: first, it identifies the actual amount in dispute, which encourages settlement where both sides recognise the amount in dispute is nominal; and secondly, it changes the relative balance of power between the corporation and shareholders, as it arms the latter with funds to pursue appraisal litigation, which, in turn, encourages the pursuit thereof.[181] Although judicial appraisal may lead to further costs and delays, it should be encouraged for two reasons: first, shareholder status ends when the shareholder makes an appraisal demand in accordance with the perfection procedure,[182] thus he/she should, at least, be compensated for the 'undisputed fair value';[183] and secondly, if minority shareholders are 'cashed-out', on terms set by the company, it is imperative that they are able to challenge the fairness of those terms in an impartial court. If the judicially determined fair value is more than the amount prepaid by the company the dissenting shareholder is compensated, for the loss of the use of the difference, through an award of reasonable interest thereon.[184]

In South Africa shareholders do not receive prepayment; they only receive payment if they accept the offer from the company and tender their shares or, if they pursue judicial appraisal, at the end of judicial proceedings. It is submitted that prepayment of the 'undisputed fair value' shall assist in giving effect to the minority shareholder protection rationale underpinning the appraisal remedy, as it will give the dissenting shareholders funds to overcome the legal cost implications associated with the perfection procedure. This shall make the remedy more accessible to ordinary minority shareholders, who do not have large cash reserves, and feel that the merger consideration offered by the company is unfair.

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[180] Model Business Corporation Act Annotation § 13.24 official comment (1999).
[181] Siegel op cit note 178 at 237.
[182] Section 164(9).
[183] Siegel op cit note 178 at 237.
[184] Mary Siegel 'Back to the Future: Appraisal Rights in the Twenty-First Century' (1995) 32 *Harvard Journal on Legislation* 79 at 141.

The court is given the discretion to award dissenting shareholders, who pursue judicial appraisal, a reasonable rate of interest on the fair value, from the date that the action approved by the resolution is effective until the date of payment.[185] This is to compensate the dissenting shareholders for the loss of the use of their funds during this period.[186] An interest award may sufficiently compensate dissenting shareholders for the loss of the use of their funds, but it does not assist their pursuit of judicial appraisal, as it is only awarded at the conclusion of those proceedings; thus prepayment should be introduced since it obviates the need for an interest award on the offered amount and simultaneously funds dissenting shareholders' pursuit of judicial appraisal. This accords with the minority shareholder protection purpose underlying the appraisal remedy and promotes its effectiveness as such.

Another limitation is the court costs of appraisal proceedings. Section 164(15)*(c)*(iv) gives the court the discretion to make an appropriate cost order having regard to the offer made by the company and the final, judicially, determined fair value. Although the discretionary nature of the cost order may encourage parties to reach *bona fide* agreement on the 'fair value', without vacuous resort to the courts, the prospect of an adverse cost order will most likely discourage shareholders from pursuing judicial appraisal.[187] The fact that valuation is not an exact science, but merely an estimate as to a range of values that may be fair, exacerbates the perceived prospect of an adverse cost order: a shareholder may believe that a difference between his/her valuation and the court's one will result in an adverse cost order against him/her.[188] Uncertainty as to the allocation of costs discourages use of the appraisal remedy; accordingly it is submitted that greater clarity is required on whom the appraisal costs are to be allocated.[189]

Under the MBCA – absent conduct that is arbitrary, vexatious or not *bona fide* by the dissenting shareholder – it is presumed that the company shall absorb the costs of judicial appraisal; however, if such 'bad conduct' is present the court has the

[185] Section 164(15)*(c)*(iii)*(bb)*.
[186] M F Cassim op cit note 86 at 806.
[187] Siegel op cit note 178 at 242.
[188] M F Cassim op cit note 86 at 808. Section 164(15)*(c)*(ii) provides that a court must determine '*a*' fair value and not '*the*' fair value. This implies that 'fair value' is a range of values.
[189] Siegel op cit note 178 at 239-240.

discretion to allocate costs to the shareholder.[190] Furthermore, it is presumed that each party shall pay their own expert and attorney fees unless the company fails to substantially comply with the appraisal procedure or either of the parties acts arbitrarily, vexatiously or not in good faith.[191] The Delaware statute, similarly to the South African one, grants the court discretion on how to allocate the costs of the proceedings; however, Delaware case law evidences an adherence to the practice of granting cost orders against the company absent *mala fides* by the shareholder.[192]

Judicial appraisal costs could easily be divided in much the same way under the MBCA or Delaware statute; but the chances of the company bearing the court costs, and the expert and attorney expenses of a shareholder, are more likely under the MBCA due to the statutory presumption thereunder.[193] The cost presumption gives dissenting shareholders more concrete assurance as to the allocation of costs than the discretionary court allocation thereof;[194] hence judicial appraisal becomes more predictable and therefore viable for dissenting shareholders.[195] The exception to the presumption, in the case of bad conduct by either of the parties, also defines the parameters within which the court may exercise its discretion to allocate costs. The comment to the section provides:

> '[T]he purpose of all these grants of discretion with respect to expenses is to increase the incentives of both sides to proceed in good faith…to attempt to resolve their disagreement without the need of a formal judicial appraisal of the value of shares.'[196]



The court's discretion to allocate costs, under s 164(15)*(c)*(iv), may encourage parties to reach agreement in good faith; however, the uncertainty as to valuation and the allocation of costs discourages dissenting shareholders from pursuing judicial appraisal if agreement cannot be reached. It is accordingly submitted that it should be statutorily presumed that the company absorbs the court

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[190] Ibid at 239.
[191] Ibid at 240.
[192] Ibid.
[193] Ibid at 241.
[194] Ibid at 242.
[195] Ibid.
[196] Model Business Corporation Act Annotation § 13.31 official comment (2008).

costs and, furthermore, that the court be given the discretion to allocate the expert and attorney costs where either party commits bad conduct. A statutory presumption to such effect shall make judicial appraisal more economically feasible for the dissenting shareholder than the current discretionary nature of the allocation of costs under the Act; hence encouraging judicial appraisal.[197] Judicial appraisal should be encouraged, as 'absent some substantial financial relief…appraisal rights are merely a theoretical right for those who own only a small number of shares'.[198] Moreover, as noted above, if minority shareholders are 'cashed-out', on terms set by the company, it is imperative that they are able to challenge the fairness of those terms in an impartial court.

By drafting such a cumbersome perfection procedure the South African legislature has failed to properly synthesise the procedure with minority shareholder protection rationale underlying the appraisal remedy, which significantly tips the scales in favour of majority shareholders as it makes the appraisal remedy too costly, time consuming and complicated for minority shareholders to feasibly pursue. In doing so the legislature has failed to utilise the perfection procedure to draw an appropriate balance between the interests of majority and minority shareholders. This seemingly evidences: (1) a conscious policy preference for the facilitation of business combinations, in the interests of economic growth, over minority shareholders' legitimate interests in their investments; and/or (2) a failure by the legislature, when looking for legislative guidance on the perfection procedure in the USA, to understand the fundamental shift that the appraisal remedy has undergone there. Although the cumbersome procedure may have the desirable effect of encouraging and promoting settlement between the dissenting shareholders and the company, without the further costs and delay of judicial appraisal, it simultaneously detracts from the appraisal remedy's effectiveness as the primary form of minority shareholder protection. Accordingly, the above recommendations should be put in place in order to achieve a better balance between protecting minority shareholders and facilitating business combinations through majority rule.

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[197] Siegel op cit note 178 at 242-43.
[198] Ibid at 243.

# VI THE COMPLEXITY SURROUNDING THE DETERMINATION OF FAIR VALUE

The judicial determination of fair value conjures up a variety of issues relating to the choice of valuation methodology, the aptness of minority discounts, whether synergy gains should be taken into account and certain institutional problems. These issues create complexity and, therefore, impact the effectiveness of the appraisal remedy as the primary form of minority shareholder protection in fundamental transactions. It is patent that

> 'the determination of fair value is the most critical element to the success of the appraisal remedy, since shareholders will hardly put the value of their investment in a court's hands if they perceive any inequity or even unpredictability in the process'.[199]

Accordingly, it is of the utmost importance that courts, when determining fair value, are cognisant of the minority shareholder protection rationale underlying the appraisal remedy.[200] The way in which the court appraises minority shares is key to the effectiveness of the remedy: if the courts appraise shares in a manner that is inconsistent with the appraisal remedy's purpose it shall become redundant, as shareholders will favour other means of challenging fundamental transactions, principally breach of fiduciary duty claims, which may be inefficient and more time consuming than appraisal.[201]

## *(a) Definition of fair value and valuation methodology*

Section 164 makes no attempt to define fair value; nevertheless the court is required to determine 'a fair value in respect of the shares of all the dissenting shareholders'.[202] The position is the same across most of the American states, which indicates a general consensus that there is no universally correct way to determine

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[199] Randall M Larsen '"Fair" Value? – The Utah Supreme Court Appraises Fair Value for Minority Shareholders under the Appraisal Remedy: *Oakridge Energy, Inc. v. Clifton.*' (1999) *Utah Law Review* 823 at 831.
[200] Wertheimer op cit note 166 at 618.
[201] Ibid at 626.
[202] Section 164(15)*(c)*(ii).

fair value as each appraisal claim generates its own particular valuation issues.[203] Accordingly, an attempt to define 'fair value' is futile since no single definition can encompass the nuances attendant upon the factual circumstances of each judicial appraisal.[204]

The ultimate determination of fair value is strongly influenced by the valuation methodology chosen.[205] The valuation methodology utilised by the court depends on the evidence presented by the parties,[206] which takes the form of expert appraisers' testimonies; hence expert consensus determines the valuation methodology utilised.[207] This accords with 'open-ended' approach to valuation adopted by the Delaware Supreme Court in *Weinberger v UOP Inc*.[208] The court stated that the determination of fair value 'requires consideration of all the relevant factors involving the value of a company', which includes 'proof of value by any techniques or methods which are generally considered acceptable in the financial community'.[209] Consequently, the court may take into account market value, net asset value, earning prospects, dividends, the nature of the enterprise and any other facts that help determine the future earning prospects of the merged company.[210] It is submitted that South African courts, when determining fair value, should adopt the open-ended approach.

Unfortunately the choice of valuation methodology does not eliminate the problems inherent in appraisal, as each valuation technique is merely a way of estimating the 'fair value' or 'intrinsic value' of the company.[211] Valuation is more of an art than a science; thus the valuation given by each of these techniques is contingent on the assumptions upon which the calculations are predicated.[212] Due to the innate subjectivity and estimation involved in valuation the parties' experts often produce substantially different results, even though they both use the same valuation



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[203] Siegel op cit note 184 at 135.
[204] Ibid.
[205] Ibid.
[206] Wertheimer op cit note 166 at 629.
[207] Siegel op cit note 184 at 135.
[208] 457 A.2d 701 at 713 (Del. 1983).
[209] Ibid at 713.
[210] M F Cassim op cit note 86 at 809 see fn 247.
[211] Wertheimer op cit note 166 at 629.
[212] Ibid.

methodology.[213] The array of valuation issues has led to appraisal becoming a ‘clash of experts’ as noted by the Delaware Court of Chancery:

> ‘“[W]e take the occasion to comment upon a recurring theme in recent appraisal cases – the clash of contrary, and often antagonistic, expert opinions on value. The presentation of widely divergent views reflecting partisan positions in appraisal proceedings adds to the burden of the Court of Chancery’s task of fixing value.”’[214]

Since appraisal ultimately boils down to a clash of highly paid experts it is crucial that the courts are cognisant of the fact that ‘whether consciously or unconsciously, the opinions expressed by the expert witnesses significantly reflect the desires of their clients’.[215] One of the primary institutional issues a court faces, when appraising the fair value of shares, is the highly divergent opinions expressed by the respective parties’ experts.[216] The Delaware courts have dealt with this in one of two ways: (1) the court decides which experts’ testimony is more credible and then accepts that experts valuation model; or (2), where appropriate, the court appoints its own expert to provide an objective presentation of evidence.[217]

Section 164(15)*(c)*(iii)*(aa)* gives the court the discretion to appoint one or more appraisers to assist it in determining the fair value of the shares. The appointment of neutral experts shall greatly assist the court in critically evaluating the opinions of each of the parties’ experts and removing some of the ‘adversarial hyperbole’ inherent therein.[218] Although the use of a neutral expert may be of great assistance to the court, two points of caution must be noted:

> ‘First, the use of an additional expert imposes additional costs to the proceeding and probably increases the time involved to reach a final result. It also adds a host of procedural issues associated with the appointment of the expert and how the expert will function in the process. The court must be careful to insure that the benefits of appointing a neutral expert justify the added time and expense and the additional layer of procedure. The second point of caution involves the potential for excessive

[213] Ibid at 630.
[214] Siegel op cit note 184 at 135 see fn 260.
[215] Wertheimer op cit note 166 at 630.
[216] Ibid at 696.
[217] Ibid at 696-702.
[218] Ibid at 700-1.

> reliance by the court on the neutral expert. The court is charged with the statutory responsibility of conducting the appraisal, and should not excessively delegate that responsibility to the neutral expert…[since] [t]he neutral expert, in all probability, will not have access to the full range of information that will be available to the court with respect to the relative equities of the parties' conduct, or may not fully appreciate such information. Accordingly, the court must guard against excessive reliance on the neutral expert.'[219]

*(b) Time of the determination of fair value*

The only guidance s 164 provides relates to the time at which fair value is to be determined. It must be determined 'at the date on which, and time immediately before, the company *adopted* the resolution that gave rise to a shareholder's rights' under s 164.[220] It is important to note that the reference point for valuation is the *adoption* of the resolution and not the earlier date of the announcement of the transaction, nor the later date of the effectuation of the transaction. This does not permit the effects of the resolution's adoption, on the value of the company or its shares, to be taken into account. In most American states the position differs to the South African position: the time at which the fair value is to be determined is immediately before the *effectuation* of the fundamental transaction to which the dissenter objects, and must exclude any appreciation or depreciation in anticipation of the fundamental transaction.[221] Although the American and South African time of determination for fair value differ, they both, essentially, prevent the courts from taking into account the synergy gains that might be derived from the proposed fundamental transaction. Surely this should depend on whether the shareholder opted-out or was forced-out of the company?

The prevention of courts taking account of the potential synergy gains has its roots in the traditional appraisal remedy, which sought to provide liquidity to dissenting shareholders trapped in a company fundamentally different from the one they initially invested in.[222] When a shareholder dissented he voluntarily elected to

[219] Ibid at 701-2.
[220] Section 164(16).
[221] Wertheimer op cit note 166 at 627.
[222] Ibid at 660.

be bought out rather than participate in the newly merged company; thus, on the basis of estoppel, the synergy gains were not taken into account in the determination of the fair value of that shareholder's shares.[223]

As pointed out on numerous occasions in this dissertation, the underlying purpose of the appraisal remedy has changed in concomitance with the altered uses of the M&A device. When appraisal statutes were originally drafted the 'cash-out' merger had not been anticipated; however, today (in the USA) 'cash-out' mergers are commonly used. When a shareholder dissents from such a merger he does not decline to continue in the company, but is eliminated from continued participation therein; thus the estoppel rationale cannot operate to prevent him claiming the synergy gains from the merger.[224] In this context the shareholder only dissents from being 'cashed-out' at the amount specified by the company; thus the estoppel rationale for, and the exclusion of, synergy gains is most out of place in 'cash-out' mergers, as it facilitates the use of the appraisal statute to oppress minority shareholders[225] and results in an 'undeserved windfall' for the majority.[226]

Professor Siegel submits that the synergy gains from a fundamental transaction should not be taken into account when determining fair value, as taking these gains into account allows the dissenting shareholder to 'have it both ways' i.e. to exit the company and simultaneously share in the future expected gains.[227] Professor Siegel further submits that in spite of the fact that shareholders are forced-out of their investments, they bear neither the costs nor the risks of the future company; thus they should not be entitled to share in its rewards.[228]

With respect, Professor Siegel's argument is *non sequitur* as it runs counter to the appraisal remedy's modern purpose of protecting minority shareholders from abuse by the majority. The fact that the 'cashed-out' shareholders bear neither the costs nor the risks of the post merger company is irrelevant; the fact is that their

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[223] Ibid.
[224] Ibid.
[225] Thompson op cit note 50 at 259.
[226] Principles of Corporate Governance: Analysis and Recommendations, Part 7, Chapter 4 (1994) §7.22 comment at 327.
[227] Siegel op cit note 184 at 139-40.
[228] Ibid at 140.

shareholding was terminated whilst they were content with their investment as it stood or even as it would have stood after implementation of the fundamental transaction. The exclusion of synergy gains was justified by the shareholder's dissent from the proposed transaction from which synergy gains were expected to be derived (estoppel justification); however, this dissent may not always be genuine: the shareholders may wish to remain in the company, and may even support the proposed transaction, but due to the fact that the fundamental transaction is structured as a 'cash-out' merger they are forced out of the company and, if they are unhappy with the amount of consideration offered for their shares, the *perfection procedure* requires that the shareholders dissent from the proposed transaction.[229] Thus, taking account of synergy gains, in the context of cash-out mergers, does not allow dissenting shareholders to 'have it both ways' since there are no two ways about it: the shareholders have no choice but to exit the company.

It is accordingly submitted that whether the synergy gains of a fundamental transaction should be taken into account, in the determination of fair value, should depend on whether the shareholder voluntarily 'opted-out' or was 'forced-out' of the company. In the former case the merger resolution's adoption should have no effect on the determination, as the shareholder does not wish to retain his investment; however, in the latter instance the effect of the resolution's adoption should be taken into account since the shareholder would have retained his/her investment had he/she not been forced-out.

*(c) The role of the market*

In the USA one of the most contentions issues, in relation to judicial determination of fair value, is the role that the market price of the shares should play in valuation. Nowhere is the contention more apparent than in regard to the 'market-out exception'. A 'market-out exception' denies the appraisal remedy to dissenting shareholders of listed companies and obligates them to sell their shares for the market price on the occurrence of a triggering event.

[229] Section 164(5)*(c)*(i).

Although the South African appraisal remedy does not contain a 'market-out exception', the conceptual basis underlying it is worth noting as it gives an indication of the potential role that the market price might play in judicial determination of fair value. There are two conceptual bases underlying the 'market-out exception'. First, it was felt that the market adequately valued shares, which accordingly made the appraisal remedy redundant for publicly traded shares.[230] Secondly, under the original liquidity rationale it would be superfluous to have an appraisal remedy that provides liquidity when it already exists in the market place; however, the appraisal remedy is no longer primarily motivated by the liquidity purpose.[231] It is presumed that in states where the appraisal remedy has been enacted without a 'market-out exception' the legislatures intended that the courts should not rely exclusively on the market price to determine fair value, since the market does not always adequately protect minority shareholders.[232]

Corporate controllers can easily depress the market price of the shares of their corporation in order to 'cash-out' minority shareholders at a low price and, thereafter, appropriate the corporate value for themselves.[233] Since the markets are forever in a state of flux the corporate controllers can manipulate the timing of the fundamental transaction, to their advantage and the detriment of the minority shareholders, by ensuring that the time when the shares' fair value is to be determined (immediately before: resolution *adoption* in South Africa and transaction *effectuation* in the USA) coincides with a dip in the corporation's share prices.[234] Moreover, they may manipulate the corporation's actions in order to artificially depress the market price of the shares at the time when the shares are to valued.

Another argument against the reliance on the market price to determine fair value arises from informational asymmetry.[235] Those in control of the corporation have access to information that minority shareholders do not and which is not

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[230] Wertheimer op cit note 166 at 633.
[231] Ibid.
[232] Ibid at 635. Moreover, minority shareholders who are cashed-out require additional protection where the merger consideration is at a premium to the market price of the shares, since deference to the market price, in such instances, shall render the appraisal remedy worthless as the primary minority shareholder protection remedy.
[233] Ibid at 638.
[234] Ibid at 636.
[235] Ibid at 638.

reflected in the market value of the shares.[236] The controllers may use such information to their advantage and unfairly relegate the dissenting shareholders to a market price that does not reflect the value of that information.[237]

It is submitted that the exclusion of a 'market-out exception', from the South African appraisal remedy, is an emphatic rejection by the legislature of the market price as an appropriate or trustworthy indicia of fair value – due to the market's susceptibility to manipulation by corporate managers. However, since minimal guidance as to the determination of fair value is given this does not mean that the market price should be completely excluded from the determination of fair value; it should just not be the sole determinant thereof. Furthermore, wholesale exclusion of the market price as a determinant is 'too crude of a choice': although the market may not always achieve the optimum price neither do the variables involved in other valuation methodology, which generally occasion much larger financial and time costs.[238]

*(d) What is to be valued?*

A fundamental issue in judicial appraisal is whether the court should attempt to value the particular minority interest held by the dissenting shareholder or, rather, attempt to value the corporation as a whole.[239] The former approach permits minority discounts whilst the latter approach does not. A minority discount is used, once the value of the corporation as a whole has been ascertained, to arrive at the value of the particular dissenting shareholder's shareholding.[240] The Delaware courts have emphatically opted to value the corporation as a whole and then award a *pro rata* portion of that value to the dissenting shareholders instead of utilising minority discounts.[241] The preference for this approach is predicated upon the purpose of the appraisal remedy: the protection of minority shareholders from majority

[236] Ibid.
[237] Ibid.
[238] Siegel op cit note 178 at 247.
[239] Wertheimer op cit note 166 at 641.
[240] Ibid.
[241] Ibid.

oppression.[242] The fulfilment of this purpose requires the dissenter to receive *pro rata* share of the corporation since

> '"fail[ure] to accord to a minority shareholder the full proportionate value of his shares imposes a penalty for lack of control, and unfairly enriches the majority shareholders who may reap a windfall from the appraisal process by cashing out a dissenting shareholder, a clearly undesirable result."'[243]

The minority discount essentially encourages majority shareholders to take advantage of the minority, as it allows the former to appropriate a portion of the value of the company from the latter.[244] The problem is compounded when the value of the corporation is determined with regard to the market price, since it already reflects the minority discount.[245] If a minority discount is imposed after a market price valuation the shares are effectively discounted twice to reflect their minority status; thus the majority appropriate the discounted value.[246] This defeats the minority shareholder rationale underlying the appraisal remedy.

The complexity created by the judicial determination of fair value shall impact the effectiveness of the appraisal remedy as the primary form of minority shareholder protection in fundamental transactions, since the determination of fair value is the most critical element to the success of the remedy. Accordingly, if the remedy is perceived to be inequitable or unpredictable by minority shareholders it shall become completely redundant and, therefore, ineffective as the primary form of shareholder protection: shareholder will opt for other remedies, which may be more inefficient and time consuming for the shareholders and the company, or they may just accept the terms of the merger agreement in spite of their unhappiness therewith.

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[242] Ibid at 643.
[243] *Cavalier Oil Corp. v Hamett,* 564 A.2d 1137,1145 (Del. 1989).
[244] Wertheimer op cit note 166 at 644-5.
[245] Ibid at 645.
[246] Ibid.

## VII AVOIDANCE OF APPRAISAL RIGHTS

The appraisal remedy can be 'a frightful nuisance, drain and burden' upon companies and their resources:[247] appraisal pay-outs and appraisal litigation costs may drain the company of valued liquidity at a time when it is most needed; the appraisal remedy may spoil corporate controllers' plans to eliminate minority shareholders on terms favourable to the company; the appraisal procedure may uncover wrongdoing by corporate controllers; and appraisal may be an administrative nuisance for the company. Consequently US companies, undergoing triggering transactions, often pay corporate lawyers vast sums of money to find legal loopholes that avoid triggering the appraisal remedy. There are two common methods of avoidance: (1) the 'kick-out' provision contained in the merger agreement of merging companies; and (2) the triangular merger structure. If these methods of avoidance are efficacious the appraisal remedy shall be completely ineffective as a form of minority shareholder protection: the remedy is not triggered; thus the shareholders are denied access to it. This section analyses the two main methods of appraisal avoidance and, thereafter, looks at the various options available to minority shareholders to overcome these methods of avoidance.

### *(a) 'Kick-out' provisions*

In the USA it is common to find 'kick-out' provisions contained in merger agreements between/among merging companies. 'Kick-out' provisions permit the boards of one or all of the merging companies to call off the merger if it becomes apparent that an 'intolerable amount' of cash may have to be paid to dissenting shareholders in the form of appraisal pay-outs.[248] The 'kick-out' provision does not prevent the triggering or operation of the minority shareholders' appraisal rights in a fundamental transaction, but rather makes the entire fundamental transaction conditional upon the number of appraisal claims made. If the 'kick-out' provision's threshold is met, the dissenting shareholders are not able to claim appraisal since the merger agreement and the appraisal triggering transaction are null and void; however, if the provision's threshold is not met, the fundamental transaction goes

[247] Manning op cit note 27 at 234.
[248] Ibid at 237.

ahead and the dissenting shareholders have access to the appraisal remedy. Accordingly, a 'kick-out' provision is not technically a method of appraisal avoidance. Quite the contrary, it actually gives effect to one of the main purposes of the appraisal remedy: to operate as a restraint on bad business judgements by the board of directors since it forces the board to reconsider its decision on the basis of the number of shareholders that claim appraisal.

*(b) The triangular merger structure as a method of avoidance*

A common method of appraisal avoidance is through the utilisation of the triangular merger structure. Unlike a traditional pooling merger (see page 15 above) in a triangular merger there are three companies involved. On the target side of the transaction there is the target company ('T Co'), while on the acquiring side there are two companies: the holding company ('H Co') and its wholly owned subsidiary company ('S Co'). The H Co is the acquiring party in *substance*, but the S Co is the acquiring party in *form*. The S Co is a shell company – holding no assets or liabilities of its own – that is specifically formed for the purposes of the merger: it functions as an acquisition vehicle in the merger with T Co. The merger is structured in such a way that the T Co merges into the S Co and henceforth becomes a subsidiary of the H Co. In *substance* the merger is between the H Co and T Co; however, due to the triangular merger structure and the companies' separate legal personalities the merger is technically (or *formally*) between the subsidiary of the H Co and the T Co.[249] Consequently the shareholders of the H Co are not entitled to vote on S Co's special resolution to merge – making approval thereof uncontentious since H Co is the sole shareholder – nor exercise their appraisal rights in respect of the transaction. Through the triangular merger structure the H Co avoids all the inconveniences associated with the appraisal right by ensuring the triggering transaction does not technically (or legally) trigger the shareholders' appraisal rights.

[249] In *R v Milne and Erleigh* (7) 1951 (1) 791 (A) at 827-8 and *Dithaba Platinum (Pty) Ltd v Econovaal Ltd* 1985(4) SA 615 (T) 625 it was held that each company in a group of companies is a separate legal entity possessing its own separate legal personality, rights, duties, privileges and liabilities separate from other companies in the group. In *Ritz Hotel Ltd v Charles of the Ritz Ltd* 1988 (3) SA 290 (A) it was held that the acts of a subsidiary company are not necessarily the acts of its holding company, and vice versa, since a subsidiary company is a separate legal entity from its holding company.

In substance the merger is between the H Co and the T Co for the following reasons.[250] First, the S Co is formed solely for the purpose of acquiring the T Co; secondly, the merger is effectively financed by the H Co; and thirdly, a triangular merger has a direct impact upon the shareholders of the H Co: if the merger consideration payable to the shareholders of the T Co is in the form of shares in the H Co this results in a dilution of the shares thereof; and if the merger consideration is cash, emanating from the H Co, it may impact on the dividends payable to the shareholders of the H Co.[251] Thus the triangular merger, when utilised as a method of appraisal avoidance, results in the disenfranchisement of the H Co's shareholders; however, some of the Act's remedies may be utilised by these shareholders to overcome the avoidance of their appraisal rights. These remedies and their effectiveness are considered below.

*(i) Clause 119(2)(b) of the Companies Bill*

Clause 119(2)*(b)* of the draft Companies Bill[252] provided that a merger must be approved by shareholders of a subsidiary's H Co, if any, if the transaction by the S Co substantially constituted a 'parallel transaction' by the H Co.[253] The term 'parallel transaction' was not defined, but it contemplated a triangular merger by which the transaction entered into by the S Co amounted to a 'simultaneous, corresponding or "parallel" transaction' by the H Co: a merger that was *formally* between the S Co and T Co, but *substantively* between the H Co and the T Co, which therefore constituted a substantially 'parallel transaction by the H Co'.[254] If this interpretation of 'parallel transaction' were correct it would have meant that the shareholders of an H Co engaged in a triangular merger would have retained their right to vote on the merger resolution and to their appraisal remedy. Accordingly, the triangular merger structure would not have been able to be utilised as a method of appraisal avoidance. However, this clause never made it to enactment and does not form part of the Act.[255] A similar protective provision is contained in s 115(2)*(b)*, but this is only applicable to the disposal of the greater part of the assets or undertakings of a

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[250] M F Cassim op cit note 69 at 706; M F Cassim op cit note 1 at 30.
[251] Ibid at 31-2.
[252] Companies Bill supra note 49.
[253] M F Cassim op cit note 1 at 31.
[254] Ibid.
[255] M F Cassim op cit note 69 at 706.

company in terms of s 112. The exclusion of this protective measure creates the potential for unfairness to the shareholders of the H Co in triangular mergers as they are denied their primary protective measure: the appraisal remedy.[256]

Could the legislature have intended to permit the avoidance of appraisal rights through triangular mergers? One could argue that the alteration of the draft Companies Bill and the restricted applicability of s 115(2)*(b)* to the disposal of assets, in terms of s 112, may indicate such legislative intent; however, such an interpretation is completely contrary to the need to balance majority and minority shareholders' rights, and provide sufficient minority shareholder protection, in light of the policy liberalisation introduced through the introduction of M&As. It is more likely that the legislature did not foresee the potentially unfair consequences that might arise as a result of triangular mergers.

*(ii) Section 41(3)*

M F Cassim submits that s 41(3) could provide a 'safety-net' for the shareholders of the H Co: it requires a special resolution by shareholders for the issue of shares in a transaction where the voting power of that class of shares comprises 30 per cent or more of the voting power of all the shares in that class held by shareholders immediately before the transaction.[257] Effectively, when the H Co issues shares to its subsidiary to be used as merger consideration in the merger with the T Co, s 41(3) gives the shareholders of the H Co a right to approve that issuance of shares; therefore it does not trigger the dissenting shareholders' appraisal remedy. Moreover, if the merger consideration takes the form of cash, and not the issuance of shares in the H Co, the shareholders thereof shall not be entitled to approve the issue of that cash to the S Co, unless the issue thereof constitutes an 'integrated transaction' as contemplated in s 41(3); nevertheless the appraisal remedy will still not be triggered. Accordingly, it is submitted that, s 41(3) provides minimal assistance to the shareholders of an H Co involved in a triangular merger as it does not trigger their appraisal remedy.

[256] Ibid.
[257] M F Cassim op cit note 1 at 32.

*(iii) Section 6(1): the anti-avoidance provision*

Since the merger is substantively between the H Co and the T Co, and only technically between the S Co and the T Co, the anti-avoidance provision, contained in s 6(1), may be of some assistance to the disenfranchised shareholders.[258] Anti-avoidance provisions are new and unusual in the field of company law and are generally found in fiscal legislation.[259] Anti-avoidance provisions aim to ensure that an 'avoiding party' cannot use the technicalities of a transaction to prevent the occurrence of the normal and natural legal consequences of the substantive transaction in which it is involved – i.e. it aims to ensure that the 'avoiding party' is not left in a position as if the legal consequences of the technical transaction were the normal and natural legal consequences of the substantive transaction.[260] [261]



[258] M F Cassim op cit note 69 at 706.
[259] Farouk H I Cassim 'Introduction to the New Companies Act: General Overview of the Act' in Farouk H I Cassim (managing ed) et al *Contemporary Company Law* 2 ed (2012) 1 at 7.
[260] My understanding and adaptation of Schreiner JA's judgment, explaining the aim of the anti-avoidance provision in the field of tax law, in the fiscal case of *Commissioner for Inland Revenue v King* 1947 (2) SA 196 (A) at 216:

> 'I do not read [the anti-avoidance provision] as a penalty section or as widening the net beyond the general scope of the Act. It seems to aim at a truer or fairer determination of the liability to the taxes imposed by the Act and their due payment when so determined. It is intended…to deal with cases in which the Commissioner…is properly aggrieved by a transaction or operation designed to enable one of the parties thereto to escape tax. The Commissioner is not properly aggrieved merely because at a stage before income has accrued to a taxpayer it might have been predicted with confidence, amounting even to certainty, that if the taxpayer took no steps in the matter such income would accrue to him, and because he then takes the avoiding steps. *But the Commissioner would be properly aggrieved if a transaction or operation were entered into which prevented income from accruing to the taxpayer while leaving him in the position of one to whom the income would normally and naturally accrue.* The section…is designed to meet the Commissioner's objections to *the creation of abnormal or unnatural situations*, to the detriment of the fiscus.' [My emphasis]

[261] Although the anti-avoidance provision seems to vest in the courts a power similar to the court's inherent power to give effect to the substance of a transaction rather than its form, it must not be confused therewith. The court's substance over form power is utilised for disguised, simulated or sham transactions. In *Commissioner of Customs and Excise v Randles Brothers & Hudson Ltd* 1941 AD 369, at 395-96, De Wet CJ defined what a 'disguised transactions' is:

> 'In essence it is a dishonest transaction: dishonest, in as much as the parties to it do not really intend it to have, *inter partes,* the legal effect which its terms convey to the outside world. The purpose of the disguise is to deceive by concealing what is the real agreement or transaction between the parties. The parties wish to hide the fact that their real agreement or transaction falls within the prohibition or is subject to the tax, and so they dress it up in a guise which conveys the impression that it is outside of the prohibition or not subject to the tax. Such a transaction is said to be *in fraudem legis*, and is interpreted by the courts in accordance with what is found to be the real agreement or transaction between the parties.'

A triangular merger transaction

> 'is not necessarily a disguised [transaction] because it is devised for the purpose of evading [a] prohibition [or requirement] in the Act… . A transaction devised for that purpose, if the parties honestly intend it to have effect according to its tenor, is interpreted by the courts according to its tenor, and then the only question is whether, so interpreted, it falls within or

Section 6(1) provides:

> 'A court, on application by the Commission, Panel or an exchange in respect of a company listed on that exchange, may declare any agreement, transaction, arrangement, resolution or provision of a company's Memorandum of Incorporation or rules –
>
> *(a)* to be primarily or substantially intended to defeat or reduce the effect of a prohibition or requirement established by or in terms of an unalterable provision of this Act; and
>
> *(b)* void to the extent that it defeats or reduces the effect of a prohibition or requirement established by or in terms of an unalterable provision of this Act.'

Prior to delving into whether the substantive requirements of s 6(1) are met, it is imperative to note that shareholders of the H Co do not have *locus standi* to make an application to the court in terms of s 6(1) – only the regulatory agencies do. Either the Companies Commission ('Commission'), Takeover Regulations Panel ('Panel'), or, if the company is listed, the exchange upon which it is listed may make the application. Accordingly, a disenfranchised shareholder will have to either: petition the pertinent exchange to make the application, if the company he is a shareholder in is listed; or initiate a complaint to the Commission or Panel, whichever has jurisdiction, in terms of s 168 alleging that his right to the appraisal remedy has been infringed.[262] After an investigation in terms of s 169 the Commission or Panel has the *choice* to decide whether to make an anti-avoidance application to court in terms of s 6(1) or not.[263]

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> without the prohibition [or complies with the requirement]… .' (*Commissioner of Customs and Excise v Randles Brothers & Hudson Ltd* 1941 AD 369 at 395.)

Accordingly, simply because the triangular merger is devised for purposes of avoiding the appraisal rights of dissenting shareholders does not mean it is a disguised transaction. Provided the 'avoiding party' honestly intends the triangular merger to avoid the triggering of the appraisal remedy, it shall be interpreted in accordance therewith, and the only question that remains is whether the triangular merger transaction falls within the purview of the s 6(1) anti-avoidance provision.

[262] Section 168(1).

[263] It is important to note that s 170(1), which provides for the appropriate course of action to be taken by the Commission or Panel after the completion of an investigation into a complaint, does not make express provision for applications in terms of other provisions of the Act (e.g. in terms of s 6(1)); however, s 170(1) states that '[a]fter receiving the report of an inspector or independent investigator, the Commission or Panel…*may*…' take any number of a listed course of actions. The use of the word 'may' indicates that s 170(1) is permissive and does not contain a *numerus clausus* of actions; accordingly the *choice* remains with the Commission or Panel to decide what course of action it shall

If the three requirements set out in s 6(1) are satisfied a court shall have the discretion to declare the triangular merger void as a method of appraisal avoidance.[264] First, the avoidance must relate to an '*agreement*, *transaction*, *arrangement*, *resolution* or *provision* of a company's Memorandum of Incorporation or rules'. The first requirement is definitely fulfilled since a triangular merger is a fundamental *transaction*,[265] regulated by a merger *agreement*[266] between the S Co and the T Co, which is approved by a special *resolution*[267] of the shareholders of both companies. Furthermore, amongst all three companies involved, a triangular merger may constitute an *arrangement*.

Secondly, the triangular merger must 'be primarily or substantially intended to defeat or reduce the effect of a *prohibition or requirement* established by or in terms of an unalterable provision of this Act'.[268] It is submitted that s 115(8) of the Act establishes a *requirement* that dissenting shareholders must be able to access the appraisal remedy if their company is involved in a triggering transaction. Section 115(8) provides:

> '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.'
>
> [My emphasis.]



Section 115(8) may be termed a conditional requirement since dissenting shareholders are only 'entitled' to their appraisal rights if they comply with subsections *(a)* & *(b)*; however, it is impossible for shareholders of an H Co, engaged in a triangular merger, to comply with these requirement since the technicalities of the triangular merger disenfranchise them of their right to vote on the special resolution; consequently a *requirement* in terms of the Act cannot be established.

pursue after the conclusion of the investigation – depending on the outcome of the investigation s 6(1) may be appropriate.

[264] Section 6(1)*(b)*.

[265] Section 115(1).

[266] Section 113(2).

[267] Section 115(2).

[268] Section 6(1)*(a)*.

This leads to a circular situation; notwithstanding, if one has regard to the aim of an anti-avoidance provision it becomes clear that this is exactly the situation for which an anti-avoidance provision is designed. Anti-avoidance provisions aim to ensure that an 'avoiding party' (H Co) cannot use the technicalities of a transaction (triangular merger) to prevent the occurrence of the normal and natural legal consequences (the triggering of shareholders' right to vote and to the appraisal remedy) of the substantive transaction (the merger between the H Co and the T Co) it is involved in.[269] Accordingly, when determining whether the prerequisites of s 115(8) have been satisfied it must be assumed that the normal and natural legal consequences of the substantive merger took place and, consequently, that dissenting shareholders would have had the opportunity to comply with the prerequisites and did comply therewith. Upon this assumption a dissenting shareholder would, in terms of s 115(8), be 'entitled' to pursue his appraisal right and, if the shareholder decided to pursue this entitlement, a *requirement* would be established: the dissenting shareholder, and ergo the company, must observe and follow the procedure laid down 'in terms of s 164'.

The requirement is established 'in terms of an *unalterable provision*' of the Act. An 'unalterable provision' is defined as

> 'a provision of this Act that does not expressly contemplate that its effect on any particular company may be negated, restricted, limited, qualified, extended or otherwise altered in substance or effect by a company's Memorandum of Incorporation or rules.'[270]

After a careful perusal of ss 115 & 164 it is evident that they do 'not *expressly* contemplate that [their] effects on any particular company', except a company undergoing business rescue,[271] 'may be negated, restricted, limited, qualified or otherwise altered in substance or in effect by a company's Memorandum

[269] i.e. it aims to ensure that the 'avoiding party' (H Co) is not left in a position as if the legal consequences of the technical transaction (triangular merger) were the normal and natural legal consequences of the substantive transaction (the merger between the H Co and the T Co).
[270] Section 1 'unalterable provision'.
[271] Section 164(1).

of Incorporation or rules'. Accordingly, ss 115(8) & 164 are 'unalterable provision[s]' as defined.

Thirdly, the triangular merger must 'be *primarily or substantially intended to defeat or reduce the effect* of a…requirement established…in terms of an unalterable provision' of the Act.[272] Accordingly it must be demonstrated that the board, acting on behalf of the H Co, utilised the triangular merger structure *primarily* or *substantially* to *defeat* the triggering of their dissenting shareholders' appraisal right. Whether this requirement is met shall depend on the facts of the transaction. In this regard it is important to note that there are various advantages related to the triangular merger structure, besides defeating the triggering of dissenting shareholders' appraisal rights, which make it an attractive merger structure. The first advantage is that the structure enables the H Co to acquire and conduct the business of the T Co as a wholly owned subsidiary (i.e. separate legal entity), which allows the H Co to protect itself from the liabilities – including contingent liabilities not discovered in the due diligence enquiry – of the T Co.[273] A second advantage is that unlike the traditional pooling merger neither the H Co nor the T Co (nor their respective businesses) need to disappear; consequently the T Co's goodwill, customer relationships, business and workforce may be maintained considerably intact and unaltered in the H Co's subsidiary.[274] A third advantage is that the rights of third party contractors and creditors of the T Co are less likely to be prejudiced by the merger since the assets and liabilities of the T Co shall remain intact, as the S Co is a shell company with no assets or liabilities of its own.[275]

Provided the *primary* or *substantial intention* of the H Co is to defeat the triggering of their shareholders' appraisal right, and not the attainment of any of the above advantages, the third requirement shall be satisfied. It is important, once again, to emphasise that this shall entail a factual enquiry, which is dependent upon the evidence brought before the court.[276] It is opined that if an H Co engages in a triangular merger primarily for the purposes of attaining the above advantages, it will

[272] Section 6(1)*(a)*.
[273] M F Cassim op cit note 69 at 705.
[274] Ibid.
[275] Ibid.
[276] The Commission or Panel will most likely have a surplus of evidence from its investigation in terms of Parts D and E of Chapter 7 of the Act.

most likely allow its shareholders to vote on the merger resolution and to access their appraisal rights; if it does not, it shall be a good indication that triangular merger is primarily intended to defeat the triggering of their shareholders' appraisal rights.

If the three requirements of s 6(1) are fulfilled the court has the discretionary power to declare the triangular merger 'void to the extent that it defeats…' the triggering of the disenfranchised shareholders' appraisal rights.[277]

It is submitted that the anti-avoidance provision contained in s 6(1) shall be an effective way for disenfranchised shareholders, of an H Co, to overcome avoidance of their appraisal rights through the triangular merger structure. Section 6(1) shall be attractive to disenfranchised shareholders because only the Commission, Panel or relevant exchange has *locus standi* to make the anti-avoidance application; therefore a proper and full investigation into the matter shall take place and neither the costs of the investigation nor the court application shall be borne by the disenfranchised shareholders. Furthermore, if the Commission or Panel does decide to make an anti-avoidance application it will probably be successful because the decision to make the application will be predicated upon the evidence produced from a full and thorough investigation into the matter.[278]

*(iv) Piercing the corporate veil*

A further option available to disenfranchised shareholders, to overcome the avoidance of their appraisal rights, is the veil piercing remedy. Company law is predicated upon the separate legal existence of companies from their controllers and owners. From the time that a company is incorporated, in accordance with the pertinent legislation, it acquires its own legal personality;[279] therefore companies are imbued with separate legal personality only by virtue of statute and, accordingly, 'their separate existence remains a figment of law, liable to be curtailed or withdrawn when the objects of their creation are abused or thwarted.'[280] One such method of curtailment or withdrawal of a company's legal personality is veil piercing. When

[277] Section 6(1)*(b)*.
[278] In terms of Parts D and E of Chapter 7 of the Act.
[279] *Salomon v Salomon* [1897] AC 22 (HL).
[280] *Ebrahim v Airport Cold Storage (Pty) Ltd* [2009] 1 All SA 330 (SCA) para 15.

the corporate veil of a company is pierced the separate legal personality of the company, along with the protection afforded thereby to the directors and shareholders thereof, is revoked, and the substance of the company is analysed rather than its form.[281]

Although veil piercing has long been a part of South African common law the Act, for the first time in our company law, introduced a statutory veil piercing procedure, which gives courts the general authority to pierce the corporate veil.[282] The statutory procedure is contained in s 20(9) of the Act. It does not override the veil piercing remedy at common law; thus where the requirements of the former are not fulfilled one may rely on latter.[283] The principles developed at common law may also serve as useful guidelines in the interpretation of s 20(9) and in deciding whether the corporate veil should be pierced or not.[284] The effectiveness of s 20(9) in overcoming appraisal avoidance through the use of the triangular merger structure is analysed below.

In order to provide context to the analysis of s 20(9) it is important to briefly look at some general principles of piercing the corporate veil at common law. The leading case on our courts' approach to piercing the corporate veil is *Cape Pacific Ltd v Lubner Controlling Investments (Pty) Ltd*[285] where the AD set out the following general principles: (1) courts should not lightly disregard a company's legal personality, since this is the cardinal reason for its existence;[286] (2) courts do not have a general discretion to disregard a company's separate legal personality;[287] (3) each case must be decided on its own facts;[288] (4) conflicting policy considerations are to be balanced against each other when deciding whether to pierce the corporate veil i.e. the need to preserve the company's legal personality must be weighed against principles in favour of piercing the corporate veil;[289] (5) separate



[281] Rehana Cassim 'The Legal Concept of a Company' in Farouk H I Cassim (managing ed) et al *Contemporary Company Law* 2 ed (2012) 28 at 41.
[282] Ibid at 57.
[283] Ibid at 58.
[284] Ibid.
[285] 1995 (4) SA 790 (A).
[286] Ibid at 803.
[287] Ibid.
[288] Ibid.
[289] Ibid at 803-4.

legal personality may be disregarded in relation to the transaction in question whilst giving full effect to it in other respects;[290] and (6) the existence of an alternative remedy does not bar the court from piercing the veil.[291] In the case of *Hülse-Reutter v Gödde*[292] the SCA seems to have overturned principle (6) as it stated that veil piercing should only be used as a matter of last resort;[293] thus, at common law, the corporate veil shall only be pierced in exceptional circumstances since separate legal personality is the very quintessence of a company's reason for existence.[294]

Section 20(9) of the Act provides:

> '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)*.'

It is debatable whether s 20(9) should be used as a remedy of last resort – as the common law remedy is.[295] It also seems that courts have a wider discretion to pierce the veil under the statutory remedy than the common law remedy.[296] It is opined that consideration must be given to the fact that veil piercing is an exceptional remedy, which should be used sparingly:[297] just because the remedy is contained in statutory form does not change the fact that the separate legal personality of a company remains the primary reason for its existence. The avoidance of



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290 Ibid at 804.
291 Ibid at 805.
292 2001 (4) SA 1336 (SCA).
293 Ibid para 23.
294 R Cassim op cit note 281 at 50.
295 Ibid.
296 Ibid.
297 Ibid.

shareholders' appraisal rights, through the utilisation of the triangular merger structure, constitutes a *prima facie* exceptional circumstance.

A disenfranchised shareholder pursuing s 20(9) must satisfy its three requirements in order to successfully overcome appraisal avoidance. First, only an 'interested person' has *locus standi* to make an application to court in terms of s 20(9); however, 'interested person' is not defined in the Act. If one looks for interpretive guidance in the equivalent provision of the Close Corporations Act[298] ('CC Act') the courts have held that it must not be interpreted too restrictively, nor must it be interpreted too widely so as to include indirect interests.[299] The court further stated that the interest is limited to a mere financial or monetary interest.[300] A triangular merger has a *direct financial effect* on the shareholders of the H Co: if the merger consideration to be allocated to the shareholders of the T Co takes the form of shares in the H Co it dilutes the shares thereof; and if the merger consideration is in the form of cash, emanating from the H Co, it may impact on the dividends payable to the shareholders of the H Co.[301] Accordingly, on the basis of the above interpretation, a disenfranchised shareholder would constitute an 'interested person' in terms of s 20(9) and, accordingly, have *locus standi* to make an application in terms thereof.

It is important to note that a disenfranchised shareholder may wish to initiate a complaint with the Commission or Panel in terms of s 168 in the hope that, after the Commission's or Tribunal's investigation is complete, it will pursue the s 20(9) remedy in the name of the shareholder (complainant) in terms of s 170(1)*(e)*.[302] If the shareholder's hopes come true it would mean that a full and thorough investigation into the matter would be conducted, which would produce vital evidence for the veil piercing proceedings, and that the costs of the proceeding would be borne by the Commission or Panel. These are substantial advantages for minority shareholders

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[298] Section 65 of the Close Corporation Act 69 of 1984.
[299] *TJ Jonck BK h/a Bothaville Vleismark v Du Plessis NO* 1998 (1) SA 971 (O) at 986.
[300] Ibid.
[301] M F Cassim op cit note 1 at 31-2.
[302] 'After receiving the report of an inspector or independent investigator, the Commission or Panel, as the case may be, may –
*(e)* commence proceedings in a court in the name of the complainant, if the complainant-
(i) has a right in terms of this Act to apply to a court in respect of that matter; and
(ii) has consented to the Commission or Panel, as the case may be, doing so…'

since they generally do not have the capacity to conduct an investigation nor the money to fund the court proceedings.

Secondly, the unconscionable abuse of the juristic personality of the company, as a separate entity, must occur either: on the *incorporation* of the company; due to the *use* of the company; or by any *act* on behalf of or by the company. When the controllers of the H Co utilise the triangular merger structure, for appraisal avoidance, an S Co is *incorporated* and *used* as an acquisition vehicle to merge with the T Co. Accordingly, the second requirement is certainly met, as there is both *incorporation* and *use* of a company (S Co).

Thirdly, the incorporation or use must constitute 'an *unconscionable abuse* of the juristic personality of the [subsidiary] company as a separate entity…'. The term 'unconscionable abuse' is not defined in the Act nor does s 20(9) give any guidance as to the facts or circumstances that would constitute 'unconscionable abuse' of juristic personality.[303] It is trite law that legislative language should be read in its 'ordinary sense'.[304] In order to determine the 'ordinary sense' or meaning of legislative language a dictionary may be used as an aid.[305] 'Unconscionable' is defined as 'irreconcilable with what is right or reasonable'[306] and 'unscrupulous or unprincipled'.[307] 'Abuse' is defined as '[a]n improper usage, corrupt practice'[308] and 'to use incorrectly or improperly; misuse'.[309] Accordingly, in its 'ordinary sense', an 'unconscionable abuse' requires an unscrupulous or unprincipled misuse of 'the juristic personality of the [subsidiary] company as a separate entity…'.

If regard is had to the rationale for the introduction of the appraisal remedy it becomes patent that the utilisation of the triangular merger structure, to avoid dissenting shareholders' appraisal rights, is an unscrupulous misuse or 'unconscionable abuse' of the separate legal personality of the S Co. The appraisal

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303 R Cassim op cit note 281 at 60.
304 *Union Government (Minister of Finance) v Mack* 1917 AD 731 at 739.
305 *Case v Minister of Safety & Security, Curtis v Minister of Safety & Security* 1996 3 SA 617 (CC) para 58.
306 William Little, H W Fowler & J Coulson 'The Shorter Oxford English Dictionary' 3 ed (1970) at 2288.
307 Morven Dooner, Elaine Higgleton & Lorna Knight 'Collins Dictionary' 9 ed (2007) at 1748.
308 Oxford Dictionary op cit note 306 at 9.
309 Collins Dictionary op cit note 307 at 7.

remedy was introduced to counterbalance the policy liberalisation that accompanied the introduction of the court-free M&As device.[310] The wide range of permissible merger consideration and structures, as well as the fact that M&As are court-free procedures, means minority shareholders are more susceptible to oppression and abuse by corporate controllers; hence the need for the appraisal remedy to function as the primary protective measure for minority shareholders in M&As. The need for minority shareholder protection is emphasised by the fact that the appraisal remedy is only available in the event of certain fundamental transactions, which indicates that such transactions have considerable and far-reaching effects upon shareholders.[311] The effects of the triangular merger are no different upon the shareholders of the H Co: if the merger consideration, payable to the shareholders of the T Co, is in the form of shares in the H Co it results in a dilution of the shares thereof; and if the merger consideration is cash, stemming from the H Co, it may impact on the dividends payable to the shareholders of the H Co.[312] Since the triangular merger structure leads to a situation where the merger is substantively between H Co and T Co,[313] and technically between S Co and T Co, the shareholders of the H Co suffer abuse and oppression without access to their primary protective remedy: the appraisal remedy. Accordingly, the incorporation and use of a S Co, in terms of the triangular merger structure, to avoid the primary protective remedy of dissenting shareholders in fundamental transactions (the appraisal remedy) 'constitutes an unconscionable abuse of the juristic personality of the [subsidiary] company as a separate entity…'.

Provided the above three requirements are satisfied the court has the discretionary power to: (1) revoke the juristic personality of the S Co 'in respect of any right, obligation or liability of the [subsidiary] company or of a shareholder of the [subsidiary] company [i.e. the H Co]…' created in terms of the merger agreement;[314] and (2) 'make any further order the court considers appropriate to give effect to…' the above revocation of juristic personality.[315]

[310] M F Cassim op cit note 86 at 770.
[311] Ibid at 796.
[312] [Reference Cassim]
[313] First, the subsidiary company is formed solely for the purpose of acquiring the target company; secondly, the merger is effectively financed by the holding company.
[314] Section 20(9)*(a)*.
[315] Section 20(9)*(b)*.

Since s 20(9) gives the court a discretion to revoke the a company's legal personality – evidenced by the use of the word *'may'* in the section – it is likely that the court will take the general common law principles, relating to piercing the corporate veil, into account when deciding whether to utilise its power or not. Thus the courts will only disregard a company's legal personality in exceptional circumstances: where the policy considerations favouring the preservation of the company's legal personality are outweighed by the policy considerations favouring the piercing of the corporate veil.[316] The use of the triangular merger, to avoid appraisal rights, constitutes such an exceptional circumstance: the policy consideration of providing minority shareholders with adequate protection in fundamental transactions, in light of their susceptibility to oppression due to the introduction of the M&A transaction, outweighs the preservation of the S Co's separate legal personality.

The avoidance of appraisal rights has proved common in jurisdictions that permit the use of the triangular merger structure. One may safely infer from cl 119(2)*(b)* of the Companies Bill that the legislature did foresee that the triangular merger structure might be used to avoid the appraisal remedy; however, exactly why the legislature did not enact the clause remains an enigma when one considers the importance of protecting minority shareholders from majority oppression in light of the policy liberalisation. Nevertheless disenfranchised shareholders are not left destitute by the Act: they may effectively utilise the anti-avoidance provision or statutory veil piercing remedy to overcome the avoidance. It is advisable to pursue the anti-avoidance remedy before s 20(9) because the courts, once the requirements of the latter are fulfilled, still retain a discretion to revoke the company's legal personality; and in the exercise of this discretion it is likely that the courts will continue to view veil piercing in light of the common law: a remedy of last resort for use in exceptional circumstance only. However, ss 6(1) & 20(9) shall only be effective provided the Commission or Tribunal takes on the proceedings; if none of them do, the enormous costs of the proceedings effectively debar the disenfranchised shareholders from access to their appraisal remedy. Accordingly, if the legislature is

[316] *Cape Pacific* note 293 supra at 803-4.

serious about the protection of minority shareholders, it should contemplate introducing a 'parallel transactions' provision for triangular M&A transactions – similar to the one contained in cl 119(2)*(b)* of the Companies bill .

## VIII CONCLUSION

The history of the appraisal remedy, in the USA, indicates that it has served, and continues to serve, a variety of purposes, which simultaneously alter with changes in the utilisation of the M&A device. Nevertheless, the appraisal remedy has consistently been aimed at providing protection to minority shareholders of companies undergoing fundamental transactions.

In the context of South African company law, the Act considerably liberalised fundamental transaction policy in the hope of growing the economy through the efficient facilitation of majority approved business combinations. The court-free nature of the M&A device, the permissibility of cash as merger consideration and the triangular merger structure all culminate to make minority shareholders highly susceptible to abuse and oppression by their dominant counterparts. Accordingly, in an attempt to balance the respective interests of minority and majority shareholders, the appraisal remedy was introduced in concomitance with the policy liberalisation.

The appraisal remedy, as it currently stands, is hopelessly ineffective as the primary form of minority shareholder protection. First, the intricacies of the perfection procedure create enormous legal compliance costs for shareholders seeking appraisal – not to mention the time implications thereof. These exorbitant costs make the pursuit of appraisal impractical, if not impossible, for minority shareholders, as they generally do not have access to the vast sums of money required to fund appraisal. Secondly, the complexity and uncertainty surrounding the judicial determination of fair value, and the court's discretion as to whom should bear the court costs, creates a fear in shareholders that, should a shareholder's estimated fair value differ from the court's one, he/she will have to bear the costs of the judicial appraisal proceedings. Thirdly, it is possible for merging companies to divest completely shareholders of their appraisal rights through the triangular merger structure. Accordingly, the ineffectiveness of the appraisal remedy in protecting minority shareholders draws a balance that favours the interests of majority shareholders over those of the minority shareholders.

In analogical terms, the minority and majority shareholders are gamblers betting on a boxing match that has been rigged by the legislature. The minority shareholders have no choice but to place their monetary interests on an inebriated lightweight (the appraisal remedy), whereas the majority shareholders place their monetary interests on the heavyweight champion of the fundamental transaction policy liberalisation (the M&A device). It is pretty patent whose interests are going to come out on top; however, all hope is not lost.

It is possible to sober the intoxicated lightweight up, put some additional pounds on him and remove the legislature's match fixing, in order to give the minority shareholders a run for their money. First, a 'substantial compliance' rule or 'harmless error' defence for trivial non-compliance with the perfection procedure should be introduced. This will often negate the need for legal assistance and the associated legal costs. Secondly, the undisputed fair value of the shares should be prepaid to dissenting shareholders who pursue judicial appraisal: it provides them with cash, which might assist them in overcoming the initial costs of judicial appraisal. Thirdly, the company should be presumed to bear the costs of judicial appraisal proceedings. This will encourage pursuit of judicial appraisal since shareholders need not fear an adverse cost order, unless they act vexatiously or frivolously. Fourthly, the courts should adopt an open-ended approach to valuation, which takes all the relevant facts and the underlying rationale of the remedy into account. Finally, appraisal avoidance can be effectively challenged through the Act's anti-avoidance provision (s 6(1)) or the veil piercing remedy (s 20(9)); however, these remedies will only be useful to disenfranchised shareholders if the Commission or Tribunal decides to take up the matter – otherwise the enormous costs of these proceedings shall ensure that these shareholders remain disenfranchised.

For the appraisal remedy to be effective as the primary form of minority shareholder protection, in fundamental transactions, it is necessary that the entire remedy be extensively simplified. The knock-on benefits of this simplification, in the form of a significant reduction in costs and time consumption, will ensure that the remedy ascends a few weight divisions and packs a heavier punch against the heavyweight M&A device; ultimately giving the minority shareholder improved betting odds for their monetary interests.

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