

# COMPULSORY ACQUISITION OF MINORITY SHAREHOLDING: A CRITICAL ANALYSIS

by

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of Master of Laws at the University of Cape Town*

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## **ABSTRACT**

The compulsory acquisition refers to situations where the minority shareholders are compelled to dispose of their shares. In certain instances the minority shareholders can compel the majority to acquire their shares by an enforced acquisition. The compulsory aspect is thus the unilateral and coercive aspect of the transaction that can arise subject to the fulfilment of certain statutory and regulatory requirements. These transactions are commonly known as squeeze-outs or freeze-outs, whereas sell outs is where minority shareholders have the right to have their shares acquired by the company on a compulsory basis.

In this dissertation the argument will be made that the objective of these forms of transactions is to relieve the majority or controlling shareholder from undue oppression by the minority shareholders not only in instances of control transferred squeeze outs but also in respect to control maintained transactions.

The dissertation will focus on the three main forms of squeeze-out transactions being the tender offer squeeze-out, the squeeze-out by means of a fundamental transaction and the supermajority squeeze-out transaction. The emphasis will be on how the first two forms of transactions are implemented in the South African context and a case will be made to include the final form in the legal framework. A specific emphasis will be given to the regulation of these transactions in ensuring the fairness to the affected minority shareholders.

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## 1 INTRODUCTION

At its core company law seeks to manage three basic relationships: between shareholders and directors, between shareholders, directors and other stakeholders and between controlling shareholders and minority shareholders.<sup>1</sup> The management of the third relationship is not more evident than in instances where there is a compulsory acquisition of minority shareholding.

The compulsory acquisition refers to situations where the minority shareholders are compelled to dispose of their shares. In certain instances the minority shareholders can compel the company to acquire their shares by means of an enforced acquisition. The compulsory aspect is thus the unilateral and coercive aspect of the transaction that can arise subject to the fulfilment of certain statutory and regulatory requirements.<sup>2</sup>

In recognising this form of transaction two rights have been developed, namely the squeeze-out right and a sell-out right. The squeeze-out right is where the controlling shareholder, or outside acquirer, after fulfilling the requirements, is able to acquire the remaining minority shareholding.<sup>3</sup> The minority shareholders are thus effectively squeezed-out of the company, hence the mechanism is commonly known as a „squeeze-out“ or „freeze-out“. The sell-out right is where after the occurrence of certain events, or fulfilment of certain requirements, the minority shareholders are able to force the acquirer or company to acquire the minorities“ shareholding.

The justification of this form of expropriation and forced acquisition of minority shareholding is based on policy taking into account interests of both parties. In some instances the value of minority shareholding may be artificially adjusted, (in favour of minority shareholders), as a result of a takeover transaction and in other instances minority shareholders may be trapped in an investment with a dominant controlling

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<sup>1</sup> H Hansmann & R Kraakman „The Basic Governance Structure in Kraakman et al „The Anatomy of Corporate Law: A Comparative and Functional Approach (2004) 33

<sup>2</sup> This form of transaction hereinafter known as „compulsory acquisitions“

<sup>3</sup> Shareholding will refer any form of applicable securities, not simply equity shareholding



shareholder. The mechanism allowing compulsory acquisition of minority shareholding may thus present relief for parties in such situations.

The squeeze-out mechanism has however been described to be the both a „visible and palpable manifestations of the controller’s raw power within the corporate legal framework“.<sup>4</sup> The role of regulation in this area is thus important in the fair treatment of the affected minority shareholders and recognising the majority rule principle in the management of companies. The main goal in the context of compulsory acquisitions should be to enhance socially desirable control transfer and control consolidation mechanisms in companies.

The South African corporate framework has been reformed by the advent of the Companies Act, 2008.<sup>5</sup> In the context of compulsory acquisitions there has been significant developments made in takeover law. The innovations (drawn from foreign jurisdictions but adapted for the South African jurisdiction) includes a statutory merger procedure, that was previously not part of the corporate framework, as well as an appraisal rights remedy for shareholders who oppose a fundamental change in a company in the form of corporate control transactions.

The key aim of this dissertation is to firstly investigate the principles surrounding compulsory acquisitions in order to establish the justification and objective of these transactions (primarily in the context statutory squeeze-out mechanisms rather than indirect oppressive methods) by examining the origins and policy considerations. This includes the basis of fairness in respect to the regulation of these forms of transactions. The focus will then shift to critically analysing the three main squeeze-out mechanisms in assessing whether the said objectives are achieved and adequate regulation is applied. The analysis will be done from a South African perspective, but will include comparative analysis from foreign jurisdictions where required.

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<sup>4</sup> V Khanna & U Varottil „Regulating Squeeze Outs In India: A Comparative Perspective“ National University of Singapore Law Working Paper Series, Working Paper 2014/009, July 2014, 4

<sup>5</sup> Companies Act 71 of 2008 (effective date 1 May 2011), hereinafter „the Act“

The structure of the dissertation is, as mentioned above divided primarily in establishing the basis of compulsory acquisitions and the analysis of the three primary squeeze-out mechanisms, being the tender offer squeeze-out, the fundamental transaction squeeze-out and the supermajority squeeze-out type. The sell-out rights of minority shareholders will also be examined in the context of each type of squeeze-out mechanism.

Chapter two of the dissertation focuses on basis of the squeeze-out mechanism, whereby the historical development of the mechanism will be examined. The chapter will then look at the policy consideration that advocates for the mechanism and the consideration that sets out why the mechanism must be regulated. An argument will be made that the objective of compulsory acquisitions should not be limited to control-transfer type but should also include the control-maintained type of squeeze-out. The control-transferred type is geared towards outside acquirers attempting to obtain full ownership of a company whereas control-maintained type is where the incumbent controlling shareholders want to eliminate minority shareholders.<sup>6</sup> The objective of this chapter is establishing the objective of the mechanism that enables an analysis of current types of mechanisms of achieving the said objective.

In chapter three the ‘tender offer squeeze-out’ type will be discussed. The core elements of the mechanism will be discussed thereafter the South African use of this type of squeeze-out will be examined in depth. Where issues arise they will be compared to jurisdictions also employing this form of squeeze-out. In particular the calculation of the threshold of acceptances will be compared with the European and New Zealand jurisdictions. We will thereafter examine the regulation of this type of squeeze-out in particular cases involving minority shareholders challenging the transaction on the basis of fairness.

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<sup>6</sup> HJ Rho „New Squeeze-Out Devices as part of Corporate Law Reform in Korea: What type of Device is required for a developing economy?“ Boston University International Law Journal at 59

Chapter four will examine the application of the squeeze-out mechanism in what is known in South African law as fundamental transactions.<sup>7</sup> The applicable fundamental transactions in this case will be the so-called „freeze-out merger“ transactions and the scheme of arrangement. A focus will be given on how the legislature has set out protection of minority shareholders who are subject to these transactions. A comparative analysis of protection devices as set out in Delaware jurisdictions will be made in respect of freeze-out mergers. The dissident shareholder appraisal right will also be discussed in the context of a minority protection device. Ultimately an examination will be made of whether there is sufficient protection to minority shareholders in terms of the Act and other applicable regulations.

In chapter five the ‘supermajority squeeze-out’ type of mechanism will be analysed. This form of squeeze-out is a pure control-maintained type of squeeze out and is not provided for in the South African corporate legal framework. Its main requirement is that if a controlling shareholder acquires a certain threshold of holding then it is able to squeeze out the remaining minority shareholders. It is thus not contingent on the making of a takeover bid or concluding a fundamental transaction but is an independent squeeze-out mechanism. Three mechanisms will be examined being the short form merger as provided in the Delaware jurisdiction, the expulsion of minority shareholders mechanism as provided in the German jurisdiction and the dominant owner mechanism as provided in the New Zealand jurisdiction. The reasoning of why this mechanism should be considered in the South African jurisdiction will be discussed by identifying possible issues pertaining to the interplay of sections in the Act that may result in the objectives of the compulsory acquisitions not being achieved.

Chapter six will contain the conclusion of the analysis where all the main issues of the in each chapter will be identified and discussed. In order to achieve the objectives set out in chapter two, proposals for consideration will be presented for consideration and to be possibly incorporated in the current South African corporate framework.

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<sup>7</sup> See Chapter 5 of the Act

## 2 THE BASIS FOR COMPULSORY ACQUISITIONS

### 2.1 Introduction

In this chapter the justification and objective of compulsory acquisitions doctrine be investigated. The origins of the doctrine will be traced in order to understand its development in the corporate legal framework. In doing so we will investigate the origins in the United Kingdom jurisdiction, (UK), and the United States jurisdiction, (US), by firstly through its development in common law through to codification of squeeze-out devices.

The origin of the South African statutory squeeze-out device is derived or predominately sourced from the same or similar provisions in the UK Companies legislation.<sup>8</sup> It is also important to examine the development of the doctrine in the US, as it will provide further context to the doctrine. Also many of the new innovations of the Act are either derived or similar to provisions in the US.<sup>9</sup>

This chapter will further focus on the policy considerations surrounding the doctrine of compulsory acquisitions. The legal aspects of corporate law such as the nature of shareholding and the majority rule principle will be examined. This section will also deal with the factors favouring the squeezing-out of minority shareholders such as the advantages of full ownership and the possible artificial value of certain holding as consequence of takeover transactions.

The examination will also look at the limitations of the justifications of the compulsory acquisitions by making a case for the regulation of the doctrine. In this

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<sup>8</sup> See s130ter of Companies Act of 1926 first inserted by s65 of the Amendment Act of 1939 which correspond with s155 of the English Companies Act of 1929, also see *Mia v Anglo-Alpha Cement Ltd* 1970 (2) 281 at 283; *Sammel v President Brand Gold Mining Co Ltd* 1969 (3) SA 629 (A) at 631; P Delpont, and Q Vorster, „Henochsberg on the Companies Act 71 of 2008 Volume 1 (2012) at 433; *Haslam and Others v Seflana Employee Benefits Organisation* 1998 (4) SA 964 (W) at 967-969; *Vlok N.O. and Others v Sun International South Africa Ltd and Others* 2011 at para 2 & 24

<sup>9</sup> MF 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

section the underlying factors recognising the unequal bargaining powers will be identified in order to determine the objectives of the regulation of the squeeze-outs.

## 2 2 Historical overview of Compulsory Acquisitions

### 2 2 1 Common Law development

The law regarding squeeze outs appears to be founded on different grounds in respect of the UK and US jurisdictions respectively as to the predominant right that it protected.<sup>10</sup>

In early US common law, the courts viewed share ownership as a form of vested right that could not be taken without consent. Therefore, all shareholders not only had the rights to retain their shares in a corporation but also had a right to veto any fundamental change in the nature of the corporation or the terms of its existence.<sup>11</sup> The basis of the so-called veto rule was on the view that the charter or memorandum or incorporation was a contract, both among the company's shareholders and between the company and the state, in which every shareholder has a vested right.<sup>12</sup> As such the US recognised shares as property rights which can only be acquired with the consent of the minority, the majority was also powerless to overcome the minority's dissent and the only way to overcome them was to purchase the minority shares per agreement.

The common law in the US, however started to recognise that the rule of unanimity, as stated above, created intolerable holdout problems and frustrated many efficient corporate transactions. As a result of these issues the rule was ultimately extinguished in favour of a rule that allowed majority shareholders to squeeze-out minority

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<sup>10</sup> P Spender *Compulsory Acquisition of Minority Shareholdings* (1993) 11 C&SLJ at 85.

<sup>11</sup> Spender *op cit* (n10) at 85

<sup>12</sup> EJ Weiss, „The Law of Take Out Mergers: A Historical Perspective“ 56 N.Y.U. L. REV. 624, 627 (1981); Rho *op cit* (n6) at 43

shareholders.<sup>13</sup> The new rule that was developed however was part of a further development in US Law whereby it was recognised the principle of the majority shareholders owing the minority shareholders a fiduciary obligation in handling the latter's property.

The UK courts tended to allow free reign of the management of a company on the basis that shareholders were allowed to sell their shares if they did not agree with the manner of management. The common law evolved on the principle of fraud on the minority. The principle of fraud on the minority is where there is improper exercise of voting power by the majority of shareholders of a company. It is the evidence of failure to cast votes for the benefit of the company as a whole. A majority in control of a company perpetrates a fraud on the minority. A resolution passed upon such voting is voidable. For example, a resolution for alteration of the articles of association to allow the compulsory purchase of the minority's shares against their wishes.<sup>14</sup>

Although the majority owes no fiduciary duty to the minority the doctrine of fraud on the minority will invalidate any apparent regular exercise of power to alter the relationship that is really a means of securing some personal gain. The power to remove shareholding of the minority must be exercised bona fide for the benefit of the company as a whole.<sup>15</sup> This principle seems similar to the shareholder protection provision of the Act which provides relief from prejudicial conduct relating to the separate personality of a company.<sup>16</sup>

The problem with this principle and balancing the interests of the majority and the minority is the determination of what exactly is meant by „to the benefit as a company as a whole. A clear illustration of this dilemma is the matter of *Brown v British Abrasive Wheel Co.*<sup>17</sup>

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<sup>13</sup> Spender op cit (n10) at 85; also FH Easterbrook and DR Fischel „Corporate Control Transactions“ (1982) 91 Yale LJ 698 at 723.

<sup>14</sup> *Phillips v Manufacturers Securities Ltd* (1917) 116 L.T. 290

<sup>15</sup> Spender op cit (n10) at 85, *Allen v Gold Reefs of West Africa Ltd* [1900] 1 Ch.656

<sup>16</sup> s163 of the Act

<sup>17</sup> [1919] 1 Ch 290

In the Brown matter the company was in dire need of a capital injection in order to avoid being liquidated as being the only viable alternative. The majority was willing to provide the capital however only if they could acquire full control of the company. The minority was however not willing to sell their shares. The majority then attempted to amend the articles of incorporation in order to effectively squeeze-out the minority. This attempt was failed since it was only to the benefit of the majority and not to the company as a whole. It is however difficult not to assume that avoiding liquidation would not be to the benefit of the company as a whole.

## 2 2 2 Codification of Compulsory Acquisition Devices

It became clear that the above common law principles was not adequate in dealing with the balance of interests between the minority and majority shareholders. In the US the response by the legislators was by introducing merger statute frameworks which in certain cases provided the majority to squeeze-out the minority shareholdings.<sup>18</sup> The most notable merger form enabling squeeze-out mechanisms was the short form merger.<sup>19</sup> This is also known as the parent company subsidiary company merger. How it works is if the holding company reaches a certain threshold (in the state of Delaware it is 90 per cent) of shares held in a subsidiary company it may effect a merger with the subsidiary in order to squeeze-out the minority shareholders. The requirement in order to effect such a merger is a simple board resolution from the holding company.

The merger framework also provided for a long form merger where the shareholding of a holding company was below the said threshold or any two companies could form a merger and effectively squeeze-out minority shareholding. The requirement here would however is much more complex and onerous including shareholding meeting

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<sup>18</sup> While Florida enacted the first cash-out merger statute in the mid 1920s, freeze-outs only became commonplace when the Delaware and Model Business Corporation Act made similar provisions in the 1950s and 1960s respectively see G Subramanian „Fixing Freezeouts“ (2005) 115 Yale Law Journal 2, 10 at 8

<sup>19</sup> A state example currently is s253 Delaware General Corporation Law (DGCL)

and resolution, proxy statement and prospectus form to be filed with the Securities and Exchange Commission.<sup>20</sup>

The lawmakers however recognised in allowing such transactions that there must be regulation in order to avoid abuse against the minority who are being squeezed out. Thus in both forms of mergers the minority shareholders were granted the right of dissenting shareholder appraisal rights, whereby they can approach the court to determine the fair value of their holdings.

The UK, (and evidently South Africa's), framework regarding a legislative squeeze-out mechanism is sourced from the recommendations of the Greene Committee.<sup>21</sup> The committee stated the following in respect to issue of dissenting minority shareholders to takeovers and schemes of amalgamations:

*'The acquiring company generally desires to obtain the whole of the share capital of the company which is being taken over and in some cases will not entertain the business except on that basis.*

*It has been represented to us that holders of a small number of shares in the company which is being taken over (either from a desire to exact better terms than their fellow shareholders content to accept or from a lack of real interest in the matter) frequently fail to come to an arrangement which commends itself to the vast majority of fellow shareholders, with the result that the transaction fails to materialise.*

*In our opinion this position- which is in effect an oppression of the majority by a minority- should be met.'*<sup>22</sup>

Based on the above statement the committee made the following recommendation:

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<sup>20</sup> Spender op cit (n10) at 86, M Lipton and E Steinberger „Takeovers and Freezeouts (1978) Law Journal Seminar Press, New York, p 422-423, s262 of DGCL

<sup>21</sup> The Greene Committee was set up by the United Kingdom's Board of Trade to examine and review Company Law in the United Kingdom. Also known as the Company Law Amendment Committee

<sup>22</sup> Board of Trade, Company Law Amendment Committee Report (1925 – 1926) at p 43



*'III. Where a scheme of amalgamation involving the transfer or a class of shares has been sanctioned by the holders of at least 90 per cent. Of the shares involved, the purchasing concern should be entitled as of a right within a limited time to acquire the shares of non-assenting holders on the same terms as those accepted by the assenting shareholders, with a right of appeal to the Court on any question of value or oppression.'*<sup>23</sup>

It is clear thus the recommendation was based on the principle that the minority should not be able to oppress the majority.<sup>24</sup> The above recommendation lead to the additional provision in the UK company legislation,<sup>25</sup> which provided in essence that where 90 per cent acceptances were received for a takeover offer the remaining shareholders who have not accepted may be purchased by the offeror on the same terms as the original offer. As this provision evolved it also allowed for a sell out provision that enabled the minority shareholders where the offer was accepted by 90 per cent of the other shareholders to force the offeror to purchase their shares on the same terms as the original offer.<sup>26</sup>

### 2 3 The Basis for Compulsory Acquisitions

In this section the considerations for the basis of squeeze-outs or compulsory acquisitions will be analysed. The said factors can be divided into two groups being the legal nature of minority shareholders in terms of the corporate law framework and the justifications of squeeze-outs from a commercial side to the benefit of the company as whole. In terms of both these groups it will be argued that the basis for compulsory acquisitions is valid. A conclusion will be sought in respect of what exactly the objectives of the squeeze-outs are in order to determine whether it is achieved by implementing the devices analysed.

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<sup>23</sup> Board of Trade op cit (n21) at p 44-45

<sup>24</sup> MS Blackman, RD Jooste, GK Everingham, M Larkin, CH Rademeyer & YL Yeats *Commentary on the Companies Act* Looseleaf (2003) Vol 3 at 15A-143

<sup>25</sup> S155 of the Company Act of 1929

<sup>26</sup> See s983 of Companies Act 2006 a

## 2 3 1 Legal Basis

### 2 3 1 1 Limited rights of a shareholder

The Act recognises a share as moveable property, which is transferable in any manner as provided by the Act or other legislation.<sup>27</sup> What is required for purposes of the squeeze-out provisions is to determine the nature of the rights afforded to the holder of the share being property and whether such rights can be limited.

The legal nature of shareholding has been explained as the following:

*'Shares are a bundle of intangible property rights property rights shareholders receive from the company in return for their contribution of cash or non-cash assets to the company. Shares define and allocate (a) income rights ie rights of participation in the company's cashflow, usually in the form of a dividend; (b) the incidence of the risk of loss, usually in the form of priority rights in relation to capital; and (c) power of control principally through voting rights. Shares are classified according to income, capital and control rights. The definition and allocation of these rights is an integral part of shares. By the reason of ownership of a share, a shareholder becomes the owner of an intangible property right in a company made up of income, capital and voting rights, all determined by the terms of the issue of the share, the company's Memorandum of Incorporation, the general law and applicable statutes of the place (ie country) of incorporation of the company. Shares are the units into which shareholders' rights of participation in the company's cash flow, management and on a return of capital and dividend.'*<sup>28</sup>

In line with the above explanation it has further been recognised shares are *jus in personam*, rights in action, whereby the extent and nature of the ownership is

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<sup>27</sup> S35 of the Act

<sup>28</sup> F Oditah „Takovers, Share Exchanges and the Meaning of Loss“ (1996) LQR 424 at 426-7; FHI Cassim, (managing ed); MF Cassim, R Cassim, R Jooste; J Shev, and J Yeates, Contemporary Company Law 2 ed (2012) at 214

dependent on the provisions set out in the statute.<sup>29</sup> The rights in respect to shareholding can thus be described as a bundle of personal rights. The extent of personal rights afforded to the shareholder in respect to personal rights of the ownership is subject to limitations as prescribed by the Act, in this squeezing-out must be seen as limitation of the right to ownership.

The argument is based on the right to ownership fails to recognise the distinction between unique nature of a share as intangible and that of other tangible properties of the company. Shareholders do not directly control the underlying assets of a company, the value of which is reflected in the shares, but focus upon their shares market value. The share value is a reflection of the company and the features of are subject of the company's performance.<sup>30</sup>

The limited nature of shareholding have been bluntly illustrated by Carney & Heimendinger as the following:

*'Minority shareholders [in the US] do not have a right to remain shareholders – however willing they may be – in the face of majority voting rules on questions as asset sales, liquidations, mergers and reverse stock splits'*<sup>31</sup>

The limited nature of shareholding is simply a result of the commercial reality to the functioning of a company and the unique rights pertaining to shareholding.

## 2 3 1 2 Majoritarian Shareholder Rule Principle

It is company law principle that the majority shareholders will in some way have supremacy over the minority in order for the proper functioning of a company. Resolutions of the shareholders are based on majority rule and only in exceptional circumstances will unanimous approval be required. Trolip JA confirmed this

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<sup>29</sup> Liquidators, Union Share Agency v Hatton 1927 AD 240 at 250

<sup>30</sup> Rho op cit (n6) at 49

<sup>31</sup> WJ Carney & M Heimendinger „Appraising the Nonextinct: The Delaware Courts' Struggle with Control Premium 152 U PA L Rev (2003) 845

principle, in *Sammel v President Brand Gold Mining Co Ltd*<sup>32</sup> whereby he stated the following:

*'By becoming a shareholder in a company a person undertakes by his contract to be bound by the decisions of the prescribed majority of shareholders, if those decisions on the affairs of the company are arrived at in accordance with law, even where they adversely affect his own rights as a shareholder. That principle of the supremacy of the majority is essential to the proper functioning of companies.'*<sup>33</sup>

The framework of modern company is based on proper governance that can only be done by allowing certain decision to the majority and not a unanimous consent. In allowing this it leads to effective management where shareholder resolutions are required. The position of a minority shareholder is thus intrinsically inferior to that of the controlling or majority shareholder.

### 2 3 2 Commercial Basis

As stated above the limitation on minority shareholders personal rights, by allowing, in certain circumstances, for the compulsory acquisition of their shares is based on policy considerations. The point of departure is thus whether such intervention is desirable or necessary.

It would seem that the inclusion of squeeze-out rules, sell out rights or appraisal rights into takeover regulation serves the purpose of mitigating types of opportunistic behaviour. Firstly, takeover regulation should help restrain opportunistic managerial behaviour in the dispersed ownership system. Small shareholders lack the incentives to effectively monitor management and rely on different mechanisms of external control. Thus the desired purpose is to protect or allow those who effectively manage the company to do so effectively without unnecessary barriers. Secondly on the other hand there must be a level of protection afforded to the minority shareholders noting

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<sup>32</sup> *Sammel v President Brand Gold Mining* supra (n8)

<sup>33</sup> *Sammel v President Brand Gold Mining* supra (n8) at 678, confirmed in *Vlok NO v Sun International South Africa* supra (n8) at para 68

that they have a right to their investment even though they do not have such a role in management or control. The exit should be on, to certain degree, on fair terms.<sup>34</sup>

In elaborating on the objective of the regulation we will look at the established justification for the general public interest which need to be guarded and lastly what exactly needs to be protected in respect of the dissenting minority on their exit.

### 2 3 2 1 Free-Rider Problem

The most recognised theoretical justification for the squeeze-out rule or principle is known as the free rider problem. Grossman and Hart<sup>35</sup> studied the dynamics of control allocations and this analysis provides for a fundamental framework for the squeeze-out and sells out right for the optimal functioning of the ownership and transfer of ownership of corporations. The theory of the free rider problem will be discussed hereunder.

When a tender offer is made the shareholders of the target company will infer that the acquiring company must believe that the target company is worth more than the tender offer price otherwise the acquiring company will not have made the tender offer and the efforts to acquire the shares of the target company. The assumption is thus that when the bidder will be in control the returns will be greater. The strategy of the target company shareholders will thus be to hold the shares and not accept the tender offer. They will thus „free ride“ on the targets company“s efforts to realise the higher value. If every target shareholder believes that her decision not to accept will not affect the offer“s likelihood of success, no one will tender, no offer will succeed and the market for corporate control will run dry. The argument is thus the ability to squeeze-out dissident minorities is necessary to discourage free riding.

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<sup>34</sup> C Van der Elst & L Van Den Steen „Opportunities in the M&A aftermarket squeezing out and selling out“ Universiteit Gent Financial Law Institute Working Paper No. 2006-12 at pg 6

<sup>35</sup> SJ Grossman & OD Hart, *Takeover Bids, the Free-rider Problem, and the Theory of the Corporation*, 11 Bell Journal of Economics 42, 43 (1980); Van der Elst op cit (n34) at 7, also RJ Gilson & BS Black „The Law and Finance of Corporate Acquisitions“ 2ed (1995) at 1238

## 2 3 2 2 Advantages of full control of a company

The exclusive control offers a number of advantages for example general meetings can be organised as the acquirer thinks appropriate (like a written general meeting), if there are no minorities that can ask questions at the general meeting of shareholders. In short, retaining a small number of shareholders can be costly. The ability to squeeze-out minority shareholders and thus obtain 100 per cent of the equity of a corporation is a basic condition for current market for corporations as full control is seen as acquisition planning.<sup>36</sup> The reason why there is the necessity to acquire all the equity in a company is the advantages of such a position and the notion that the ability to exploit these advantages should not be unreasonably being prevented. We will hereunder examine the said advantages of full control of a company also in particular from a take over market perspective.

### i Access to assets of target company

In takeover transactions it is not uncommon for an acquiring company to be dependent on the access to a target company assets in order to pay off the debt incurred to finance the acquisition. If minority shareholders are not eliminated, the argument goes, then whether what is sought is the company's existing cash, or the proceeds of the of post-acquisition sales is the target company assets, the price of the acquiring company's access to those resources is the distribution of a proportionate amount to any remaining minority shareholders.<sup>37</sup>

### ii Delisting

A possible reason for needing the eliminate minority shareholders is simply cost considerations associated with having minority shareholders. The squeeze out provision can assist greatly in the process of delisting or going private. Being a public company listed on an exchange not only cost money to the exchange it also brings

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<sup>36</sup> Van Der Elst op cit (n34) at 9

<sup>37</sup> Gilson op cit (n35) at 1239

about significant compliance obligations with not only company legislation but also with regulations pertaining to exchanges. There is thus at times incentive for companies to delist or to become private companies.

A successful takeover does not necessarily allow the bidder delisting the target and fully integrate the acquired company. A squeeze out helps this process if the relation between the different legal instruments is not disputed.<sup>38</sup>

In the South African context the voluntary delisting from the Johannesburg Stock Exchange (JSE) is done in terms of a procedure set out in the JSE Listing Requirements.<sup>39</sup> The process is a fairly onerous approach whereby amongst others the

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<sup>38</sup> Van Der Elst op cit (n34) at 9

<sup>39</sup> JSE Listing Requirements para 1.13 – 1.16:

**Removal at the request of issuer**

- 1.13 An issuer may make written application to the JSE for a removal of any of its securities from the List, stating from which time and date it wishes the removal to be effective. The JSE may grant the request for removal, provided paragraphs 1.14 and 1.15 are properly complied with and perfected.
- 1.14 Prior to being able to effect paragraph 1.13, an issuer must send a circular to the holders of its securities complying not only with the requirements of paragraph 11.1 (contents of all circulars) but also with the following:
- (a) where the issuer is a listed company, approval must be obtained from shareholders in general meeting for the removal of the listing prior to the issuer making written application for such removal;
  - (b) the reasons for removal must be clearly stated;
  - (c) an offer (which must be fair in terms of paragraph 1.14(d)) must be made to all holders of listed securities with terms and conditions provided in full; and
  - (d) a statement must be included by the board of directors confirming that the offer is fair insofar as the shareholders (excluding any related party/ies if it/they are equity securities holders) of the issuer are concerned and that the board of directors has been so advised by an independent expert acceptable to the JSE. The board of directors must obtain a fairness opinion (which must be included in the circular), prepared in accordance with Schedule 5, before making this statement.
- 1.15 Where approval is required in terms of paragraph 1.14(a), more than 50% of the votes of all shareholders present or represented by proxy at the general meeting, excluding any controlling shareholder, its associates and any party acting in concert, and any other party which the JSE deems appropriate, must be cast in favour of such resolution, unless the JSE otherwise decides.
- 1.16 Shareholder approval for the removal of the listing need not be sought, and a circular need not be sent to the holders of securities where the listing of such securities is intended to be removed:
- (a) following a take-over offer, the securities have become subject to Section 124 of the Act and notice has been given by the offeror of its intention to cancel the listing of the securities (in these circumstances) in the initial offer document or in any subsequent circular sent to holders of securities; or

shareholder approval and a regulated offer for holdings are required. The procedure however makes specific exceptions whereby the abovementioned process is not required this makes specific reference to the tender offer squeeze out provision in terms of s124 of the Act and other takeover mechanisms.<sup>40</sup> It is thus clear the ability of compulsory acquisition of minority shareholding is vital in the process of voluntarily delisting from an exchange and in this case the JSE.

### iii Gains from synergy

One of the main incentives from acquiring full control of a company is to avoid unnecessary obstructions from operating a company. This is important from a group context of companies. In a group of companies the board of directors of the fully controlled subsidiary can align the management of the subsidiary with the groups strategy and subordinate the interest of the subsidiary. If however there are a minority shareholding the board of directors will be compelled to take into account the interests of those shareholders in its decision procedures. It can therefore possibly stifle the objective of a certain acquisition or cause undue consideration to smallholding.

Synergy gains from pivotal considerations in respect to acquisition factors. In groups of companies it can be difficult to structure the development of new activities if the group management must take into account the interests of the minority shareholder.<sup>41</sup>

## 2.4 The Basis for Regulation

The role of regulation in respect of compulsory acquisitions is the balancing of interests of both parties. The coercive nature of the said transaction requires the law to ensure that affected minority shareholders are treated fairly. In this section the factors that may lead to opportunistic behaviour and abuse of the compulsory

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(b) following the completion of a scheme of arrangement with shareholders, in terms of Sections 114 and 115 of the Act, as a result of which either all the shares have been acquired or the JSE is satisfied that the issuer no longer qualifies for listing (the JSE must be consulted for a ruling in this regard).

<sup>40</sup> Ibid para 1.16

<sup>41</sup> Gilson op cit (n35) at 1246-1247



acquisition devices are identified in order to ensure that occurrence of such factors are controlled.

#### 2.4.1 Conflict of interests

Squeeze-out transaction can create a potential conflict of interests between controlling and minority shareholders. The reason is that squeeze outs are mainly recognised as self-dealing transactions.

Self-dealing occurs when one takes an action in an official capacity which involves dealing oneself in a private capacity and which confers a benefit on oneself. In a corporate context, an officer or other fiduciary who takes advantage of his or her position by putting self interests before, rather than after, the principle's (eg shareholders) interests during the course of a specific transaction engages in a self-dealing transaction.

The controlling shareholders ability to abuse the managerial power of a corporation to the detriment of the minority shareholders creates a serious conflict of interests between the controlling and the minority shareholders themselves. The minority shareholders are left facing the risk of a freeze out. In such a context, the minority shareholders may be the victims of the real rights conferred on controlling shareholders: after a controlling shareholder has exerted these rights, it is the minority shareholders who are ejected from the firm.<sup>42</sup>

The inherent conflict of interest may lead to opportunistic squeeze out transaction that might be unduly unfair to minority shareholders. This is a result of the so called „lemons effect“ in business transactions. A „lemon effect“ is created when controllers are able to use their own private information to establish a squeeze-out terms favourable to the controller. This information may be the acquisition of a very valuable contract to the benefit of the company which the minority and market is not aware of. Under a regime where the squeezed-out minority shareholders receive

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<sup>42</sup> L Pinta „The U.S. and Italy: Controlling Shareholders“ Fiduciary duties in Freeze Out Mergers and Tender Offers“ (2011) NYU Journal of Law & Business Vol 7 931 at 933

compensation equal to the pre squeeze-out market prices to be set at a level below the no squeeze-out value of minority shares.<sup>43</sup>

## 2 4 2 Investment concerns of minority

The holding of shares in a company is an investment in that company most commonly for growth in the initial investment. It can therefore be seen that the concept of the share is a risk taking and to a certain degree the holder of the share should be allowed prerogative in respect to that risk taking. The concern in respect to squeeze-outs is that the minority shareholder loses control of his or her investment even against their will.

A controller might decide to pursue a squeeze-out knowing that the target is about to receive a very profitable opportunity and thus denying the minorities the ability to share in those profits, even though it can in certain cases be argued that the said opportunity only arose because of the initial risk taken by all shareholders. A controller can also propose a squeeze-out right after a stock market decline in order to take advantage of the targets lower market price, even though the lower price may be transitory. There is some suggestion that the going private wave of the 1970's in the United States was an example of this.<sup>44</sup>

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<sup>43</sup> LA Bebchuk & M Kahan „, Adverse Selection and Gains to Controllers in Corporate Freezeouts“ Concentrated Corporate Ownership [Textbook title] 247 -264 (Randall K Morck ed., 2000) available at <http://ssrn.com/abstract=147568>

<sup>44</sup> Khanna op cit (n4) at 7, Also see A.A. Sommer, Jr., Law Advisory Council Lecture, Notre Dame Law School, Nov. 1974, available at <https://www.sec.gov/news/speech/1974/111474sommer.pdf> accessed on 1 September 2015, specifically at 17 where the commissioner stated the following: ‘  
*Speaking only for myself, I find it very difficult to believe that the use of the tactics I have discussed in order to freeze out minority shareholders or deprive them of a market for their stock or the protection of the federal securities laws, really constitute protection of them or contribute anything to the integrity of the market place.*’

## 2 4 3 Exit Mechanisms: Sell-Out Rights

As stated in the introduction the sell-out right afforded to minority shareholders is a device whereby they can coerce the controlling shareholder or the new acquirer to purchase their holdings. The sell-out right can also be utilised in the form of shareholder appraisal right whereby if there is a fundamental change in the company that a certain shareholder objects he may be cashed out and consideration is determined by court intervention.

In the tender offer squeeze-out the sell out right is mainly utilised as an exit mechanism. On the same principle as the mandatory offer provision it affords a shareholder to withdraw from his or her investment due to effective control being afforded to a certain shareholder and can be viewed as a fundamental change in the functioning of the business. The use of the sell-out right in tender offers is the recognition that the squeeze-out is inevitably a choice by the controller and as such the minority shareholder should also be afforded the similar choice to be cashed-out.

An important exit mechanism is the shareholder appraisal right. It allows dissenting shareholders to proposed fundamental transactions and amendments to the Memorandum of Incorporation (MOI) the right to have their shares acquired by the company in exchange for cash on a fair value that can be determined judicially. The appraisal remedy however serves further objectives relating to protection for minority shareholders than only as exit mechanism that will be discussed in respect to the chapter dealing with compulsory acquisitions in fundamental transactions.<sup>45</sup>

## 2 5 Conclusion

The original justification of the squeeze-out right was to remedy the mischief of the minority oppressing the majority in acquisition transactions. The notion being that a small minority shareholders group should not be entitled to obstruct or prevent a takeover transaction by not accepting an offer which has been accepted by an overwhelming number of the offerees. However in analysing the advantages of full

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<sup>45</sup> See Chapter 4 4 3

ownership and legal basis for shareholding raises the argument whether the squeeze-out can be applied in a take over transaction but at any stage the controlling shareholder reaches the threshold shareholding.

The argument is that the squeeze-out right should not be limited to control transfer types but also by virtue of the development minority protection devices to control maintained types.

The test of such argument would be is it in the interest of the company as a whole to if such a mechanism is allowed. It is clear from the above analysis that full ownership or a company becoming a wholly owned subsidiary has benefits for the controller and is in line with a more efficient framework as unnecessary costs involved as a result of having minority shareholders and other benefits has stated above.

In examining the squeeze out provision in the South African corporate framework further in this dissertation it will be noted that there may be value in applying the above argument to have a further mechanism. This is as a result with issues related to the interplay of certain provisions of the Act.

The caveat of the squeeze out provision is ensuring the fair treatment of the affected minority shareholders. This is more complex than simply providing consideration equal to the market price of their holding. In allowing the squeeze out provision there must be regulation that ensures the fair treatment of the affected minority shareholders.

### 3 TENDER OFFER SQUEEZE-OUT

#### 3.1 Introduction

A tender offer type squeeze-out is a legislative mechanism that forms part of a two-step transaction. First, in the tender offer stage, the offeror makes a public offer to attract shareholders in a target company. Second having successfully obtained the minimum level of shares required by the squeeze-out regulation, („the threshold“), the offeror is allowed to acquire the shares held by the remaining minority shareholders in the compulsory acquisition stage. After the successful tender offer and subsequent acquisition of the remaining shares, the offeror will have obtained 100 per cent ownership of the target company.<sup>46</sup>

The objective of the mechanism is for the acquirer who has provided considerable amounts of capital to be able to obtain the benefits of full ownership and not be oppressed by dissident or apathetic minority shareholders.<sup>47</sup>

This type of transaction allows not only controlling shareholders but also outside acquirers of a target company. The main requirement is not the shareholding of the controlling shareholder but the number approvals provided for a tender offer. The mechanism is thus geared towards a control-transferred type of squeeze-out whereby it provides outside acquirers a means to obtain full ownership without the fear of a

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<sup>46</sup> Rho op cit (n4) at 55

<sup>47</sup> See Blackman op cit (n24) at 15A-143 and Vlok supra (n8) at para 74: *„The legislature is concerned that the offeror, who may expend considerable sums of money in the expectation of acquiring total ownership of the shares in the target company, should not be prevented by a small minority of shareholders from acquiring total ownership of the shares and, if a corporate offeror, from converting the company into a wholly-owned subsidiary, and so obtaining the commensurate and legitimate benefits financial, administrative and commercial that go with such ownership. In England, experience, prior to the introduction in 1928 of the legislation to facilitate by the coercion of dissenting shareholders the amalgamation of companies, suggested that the holders of small numbers of the shares might, out of desire to exact better terms than the vast majority of their fellow shareholders were content to accept, hamper the arrangement or prevent it from materializing. Thus the object of the legislation was in effect to prevent an oppression of the majority by a minority.’*

small number of dissident or apathetic minority shareholders preventing a full ownership acquisition.

In this chapter we will examine the tender offer squeeze-out provision provided in the Act. We will also examine how it is regulated in terms of case law principles where minority shareholders have challenged the transaction and in terms of takeover regulations.

### 3.2 Squeeze-Out Mechanism in terms of the Act

The provision provided in the Act<sup>48</sup> is the statutory squeeze-out device, which is the second part of the two-part transaction in order to obtain full control of a target company by an acquirer. It contains numerous procedural elements however the objective is to enable an offeror whose offer has been accepted by the holders of 90 per cent of the securities involved (ie other than those already held at the date of the issue of the offer by, or by a nominee for, the offeror or a related or inter-related party or somebody acting in concert) to acquire any or all of those securities whose holders have not accepted the offer on the terms applicable to those who have and to compel the acquisition by the offeror his securities. The nuances and procedural elements of the said provision will be discussed further hereunder.

The compulsory acquisition and squeeze-out provision of the Act states the following:

*(1) If, within four months after the date of an offer for the acquisition of any class of securities of a regulated company, that offer has been accepted by the holders of at least 90 percent of that class of securities, other than any such securities held before the offer by the offeror, a related or inter-related person, or persons acting in concert, or a nominee or subsidiary of any such person or persons-*

*(a) within two further months, the offeror may notify the holders of the remaining securities of the class, in the prescribed manner and form-*

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<sup>48</sup> s124 of the Act

- (i) *that the offer has been accepted to that extent; and*
- (ii) *that the offeror desires to acquire all remaining securities of that class; and*
- (b) *subject to subsection (2), after giving notice in terms of paragraph (a), the offeror is entitled, and bound, to acquire the securities concerned on the same terms that applied to securities whose holders accepted the original offer.*

The first aspect to note is that the statutory squeeze-out relates to a tender offer and the threshold is in terms of acceptances of the offer and not previously owned shares or further conditions as stipulated in the provision. This includes shareholding held by related, inter related or persons acting in concert with the acquirer.<sup>49</sup> The requirement is thus that the acquirer must receive approvals from shareholders holding 90 per cent of the shares to which the offer has been made. This is difficult to achieve, as one can see from an illustration. In case the acquirer, such as a controller, holds 70 per cent shares in the company and wishes to squeeze-out the remaining shareholders, it must first make an offer to the minorities holding 30 per cent of the shares, in order for the acquirer to be eligible to effectuate a squeeze out, the offer must be accepted by shareholders holding at least 27 per cent shares in the company (i.e. 90 per cent of 30 per cent shares).<sup>50</sup>

The second facet of the provision is that it is limited to regulated companies. A regulated company in terms of the Act is public companies, state-owned company or a private company that has expressly provided that it is regulated company in its MOI or if a private company has in any 24-month period, of more than 10 per cent of the value of their issued shares. This figure of more than 10 per cent can be over a number of transactions during a 24-month period.<sup>51</sup> The objective of the distinction between regulated companies and other private companies is recognition that in the

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<sup>49</sup> The objective of this seems as a minority protection and prevents loopholes for the acquirer in applying the mechanism by acting in concert.

<sup>50</sup> Khanna op cit (n4) at 13

<sup>51</sup> s118(1)(c) read with reg 91

initial start-up phase of a private company the burden of compliance with applicable provisions in the Act and Regulations, in many instances be unduly harsh on a private company.<sup>52</sup>

A further noticeable feature of the provision is that it defines the tender offer as „an offer for any class of securities“ and if accepted by the threshold of that class of securities the requirement has been met. This seems to be an illogical since the objective of the squeeze out mechanism is to obtain full control of the target company. The provision however provides for a squeeze out of not the whole company but also for classes of securities. The justification of the squeeze-out mechanism does not seem to include for example the complete acquisition of the class of preference shares with a preference right at liquidation. The point being that some classes of shares that may be minimal or insignificant in terms of the total holding or influence in the target company.

The acquisition of a class of securities which is minimal does not seem able to extract the benefits of full ownership such as to eliminating the cost of minority shareholding or delisting. There may be an instance of application of the free rider problem in respect to an offer for the acquisition of a class of securities however is it justifiable without the benefits of full ownership.

In order to address this issue it must therefore be defined what is full ownership in the squeeze out justification basis. One of the possible definitions of full ownership in this context is when the target company becomes a wholly owned subsidiary of the acquiring company, (in the case if the acquirer is a company). The definition of a wholly owned subsidiary another company is held or controlled the entire general voting rights with the issued securities of the target company.<sup>53</sup> The argument can thus be made that the tender offer squeeze-out mechanism should only be available when the threshold is 90 per cent of the general voting rights in the target company.

The rationale for the providing the squeeze-out mechanism in respect of each class of securities is possibly recognition that different classes of securities may have

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<sup>52</sup> Takeovers Regulations Panel Guideline note 3/2011

<sup>53</sup> s3(1)(b) of the Act



different values. The mechanism provides that those minorities being squeezed-out must be on the same terms as the original offer. Thus providing for each class of securities creates uniformity and prevents the abuse that those holders of a more valuable class of securities being required to accept an offer which is based on a less valuable or average valuation of all the classes of securities.

The issue of offers relating to different classes of securities is referred at the provisions dealing with comparable offers. In the said provision it provides that should an offeror make an offer in regulated company containing more than one class of securities and the result is if accepted the offeror has more than the prescribed percentage of general voting rights he must make a comparable offer to each class of securities.<sup>54</sup> The point being if this provision can deal with the different classes of securities why should the squeeze-out mechanism be allowed to differentiate between classes of securities and not concern itself with the general voting rights of the offer.

In considering this issue a comparative perspective on jurisdictions that also provide for the tender offer squeeze out will provide some insight. The best possible comparison would probably be the guidance provided by the European Union Takeover Directive<sup>55</sup>, which provide guidelines for member states in order to have a certain level of uniformity in respect to takeover regulations.<sup>56</sup> On the issue of application of the squeeze-out mechanism on a target company that provides for more than one class of shares the directive states the following:

*‘Where the offeree company has issued more than one class of securities, Member States may provide that the right of squeeze-out can be exercised only in the class in which the threshold laid down in paragraph 2 has been reached.’<sup>57</sup>*

The above guiding principle has been incorporated in the UK tender offer squeeze-out mechanism.<sup>58</sup> The provision however does contain an additional requirement that

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<sup>54</sup> s125(2) of the Act

<sup>55</sup> Directive 2004/25/EC of the European Parliament and of the Council (the 'Directive')

<sup>56</sup> See the preamble of Directive

<sup>57</sup> See Article 15 at para 3 of the Directive

<sup>58</sup> See s979(1) read with s974 of Companies Act 2006 also G Morse „Palmer’s Company Law: Annotated Guide to the Companies Act 2006“ (2007) Sweet & Maxwell Limited at 719

the acceptances must in the case where the class of shares has voting rights, the threshold of the voting rights of that class of shares.<sup>59</sup>

The position regarding the tender-offer squeeze-out is however different in the New Zealand jurisdiction. The squeeze-out device is more independent from the tender offer. If the tender offer results in an offeror becoming a dominant owner then the offeror can acquire the remaining minority shareholders holdings on same terms as the original offer.<sup>60</sup> A dominant owner is a person or two or more persons acting in concert who become holders of 90 per cent of the voting rights in a company.<sup>61</sup> The requirement in terms of acceptances of the offer is that 50 per cent or more of the equity shares in respect of the offer must have been accepted. This does not include securities held by the controller before the offer. Also the squeeze-out consideration in any class must be the same as consideration provided in the offer for equity securities in that class.<sup>62</sup>

The threshold set in the provision is 90 per cent acceptances of the securities in a class. This threshold is in line with jurisdictions that provide for the tender offer squeeze-out mechanism. The European Union Takeover Directive provides that member states should have a threshold level between 90 per cent and 95 per cent in order to utilize a tender offer squeeze-out.<sup>63</sup>

The procedural elements of the provision are that the offeror must reach the threshold of acceptances within four months of date of which the offer was made. The offeror has after the threshold been established two months whereby to provide notices informing the remaining security holders of his intention to acquire their holdings. He must also notify the remaining holders of the level of acceptances of his offer.<sup>64</sup> This is important in respect to the sell out right of the remaining shareholders.<sup>65</sup> The

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<sup>59</sup> See s979(2)(b) of Companies Act 2006

<sup>60</sup> See Rule 56 of the New Zealand Takeovers Code („the Code“)

<sup>61</sup> See Rule 50 of the Code

<sup>62</sup> See Rule 56(1);(3) of the Code

<sup>63</sup> See Article 15 at para 2 of the Directive

<sup>64</sup> s124(4)(a) of the Act

<sup>65</sup> s124(4) of the Act

remaining shareholders can then enforce their sell out rights within three months of receiving the notice regarding the acceptances on the same terms as the original offer.

### 3.3 The regulation of the tender offer squeeze-outs

As stated above the primary role of regulation is to ensure that the affected minority shareholders are treated fairly. In tender offer squeeze-outs this is mainly done through creating procedural requirements that the acquirer must comply with before she can squeeze-out the minority. One of the purposes of the procedural requirements is to provide the affected minority an opportunity to challenge the contemplated squeeze-out transaction.

In the Act provision is made for recourse by the minority to challenge the contemplated transaction in order to obtain relief by either not entitling the offeror compulsory acquisition under the provision or imposing terms different to the original offer.<sup>66</sup> The primary criterion of the abovementioned discretion is the fairness of the affected transaction on the shareholders involved.<sup>67</sup> This means that the court has to determine whether the terms of the offer made and accepted by majority is fair on all the shareholders affected. This test is subject to established principles, which has been developed in common law in respect to this remedy. The onus of proving the alleged unfairness is on those who allege it, in respect to this remedy it will be on the applicant dissident minority shareholders.<sup>68</sup>

In challenging this form of transaction courts have presumption of fairness due to the offer being accepted by the overwhelming majority of the offerees. The design of the device is such that only taking into account acceptances and not taking into account the offeror's holdings can only abuse it in special circumstances. There is thus a built in approval mechanism of the supermajority of the minority shareholders. In this section the cases where the tender offer squeeze-out has been challenged will be

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<sup>66</sup> s124(2) of the Act

<sup>67</sup> *Sammel v President Brand Gold Mining* supra (n8) 630; *Mia v Anglo Alpha Cement* supra (n8) at 283, *Delpont* cit op (n8) at 436

<sup>68</sup> *Mia v Anglo Alpha Cement* supra (n8) at 283

examined. The main principles derived from these cases will be identified and discussed.

### 3 3 1 Fairness on the general body of shareholders

The largest body of case law concerning objections to tender offer squeeze-outs are from the UK and many jurisdictions, including South Africa have relied on principles that are derived from these cases. One of the most relevant case in respect of the nature of this remedy is from the matter of *In Re Grierson, Oldham and Adams Ltd.*<sup>69</sup> In that matter the dissident minority shareholders after receiving a statutory notice to acquire their shares<sup>70</sup> applied to court tender offer in respect of the notice was unfair on the following grounds:

- i. The price offered for the shares was lower than the market price of the shares relating to previous years;
- ii. The assets and the prospects of the company warranted a higher price;
- iii. The price offered did not recognise the advantages to be obtained by the offeror in respect of the acquisition;
- iv. The offer price was slightly above market price but it is as result of a depressed market resulting from external factors and its common that take over price offer exceeds market price considerably;
- v. The offer price compared unfavourably compared to price offers of other classes of shares;
- vi. The applicants would be compelled to sell shares at loss from original investment and would not be capable to deduct from capital gains tax.

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<sup>69</sup> [1968] 1 Ch 17 32; [1967] 1 All ER 192 197

<sup>70</sup> s209 companies act 1948

The evidence presented by the applicants was done by an independent expert and was unchallenged, as the respondent company presented no evidence to contrary. The court thus accepted the evidence on all the abovementioned grounds. It would seem at this stage on the evidence that the offer price given is unfair to the dissident minority.

The chancery division however upheld the principle that the test of fairness is not on the applicant minority but upon all the affected shareholders including those who did not oppose and accepted the offer. The court to this effect stated the following:

*‘When considering whether a scheme is fair or not what the court must consider is whether it is fair or unfair on the general body of shareholders, and not whether it is fair or unfair to the individual shareholders. The offer price was not inadequate and its fairness is sufficiently demonstrated by the fact that over 99 per cent of the shareholders have accepted it.’<sup>71</sup>*

The court further confirmed that for this remedy to succeed the court must find that the offer or scheme to be „obviously unfair, patently unfair, unfair to the meanest intelligence“<sup>72</sup> and it is not sufficient to show that the offer was not as generous as it might have been.

The principle is thus that the test of fairness is applied on all the body of shareholders not just those shareholders who are the applicants or were subject to the squeeze-out.

### 3 3 2 Special circumstances

It is clear from the above principle that the onus of proving the unfairness of the tender is exceptionally difficult taking into account the large number of shareholders who accepted the offer. The common law have however recognised in some instances that there are special circumstances in which presumption of fairness less likely. In such instances the fairness test can also be on the dissident shareholders and not just the general body of shareholders affected by the transaction.

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<sup>71</sup> at 26 G

<sup>72</sup> In re Sussex Brick Co Ltd [1961] Ch 289n

The principle or exception of special circumstances was first noted in the matter of *In Re Hoare and Co. Ltd.*<sup>73</sup> where Maugham J said the following:

*'prima facie the Court ought to regard the scheme as a fair one inasmuch as it seems to me impossible to suppose that the Court, in the absence of very strong grounds, is to be entitled to set up its own view of the fairness of the scheme in opposition to so very large a majority of the shareholders who are concerned. Accordingly, without expressing a final opinion on the matter, because there may be special circumstances in special cases, I am unable to see that I have any right to order otherwise in such a case as I have before me, unless it is affirmatively established that, notwithstanding the view of a very large majority of shareholders, the scheme is unfair. There may be other grounds, but I see no other grounds available in the present case for the interference of the Court'*

One clear example of the so called special circumstances was recognised was in the matter of *In re Bugle Press Ltd.*<sup>74</sup> the facts of the matter were as follows:

The transferor company, Bugle Press Ltd, had three shareholders, with the two main shareholders holding 4500 shares each. The sole minority shareholder held 1000 shares. The two main shareholders, holding 9000 shares, incorporated the transferee company of which they were the sole directors and shareholders and was incorporated for the sole purpose to effect the acquisition of the transferor company. The new company acquired the shareholding of the two main shareholders and proceeded to squeeze-out the minority shareholder by virtue of having nine tenths of the total shares in the company.

In that matter the court found that there is sufficient grounds to refuse the acquirer to squeeze-out the affected remaining minority shareholders. It is clear in this situation the two main shareholders can easily collude and the offer consideration can be manipulated in order to utilise the squeeze-out on terms that are unfair to the minority shareholder.

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<sup>73</sup> [1934] 150 L.T. 375 (also reported at 1933 All E.R. 105) as confirmed in the *Mia* judgment

<sup>74</sup> [1961] 1 Ch. 67 CA

### 3 3 3 Non-compliance with procedural requirements

It is self evident that the best possible manner to challenge the fairness of a transaction is by alleging non-compliance with the procedural requirements of the provision. As stated the procedural grounds serve the purpose of informing the minority shareholders and offering them an opportunity to challenge the validity of the purported squeeze-out. In *Rathie v. Montreal Trust Co.*<sup>75</sup> the Supreme Court of Canada found in favour of dissident minority shareholders based on non-compliance with the statutory time period of the notice to the shareholders.<sup>76</sup>

### 3 4 Conclusion

The tender offer squeeze-out device deals directly with the mischief of oppression by the minority on the majority in takeovers as identified by the Greene Committee.<sup>77</sup> The device is also very efficient as it does not require extensive minority protection methods in order to ensure fair treatment of the affected shareholders. This is as a result of the original offer being presumed fair if accepted by the supermajority of the offerees.

The issue however in respect to the application of the device is that would it give effect to the objectives of compulsory acquisitions if it can be applied to only a class of securities. This issue may need some consideration as it may be open to abuse or it may simply be utilised arbitrarily. There may need to be a restriction of some sorts that it cannot be utilised when it deals with an insignificant class of securities in the company.

It should however be kept in mind that the device is contingent to a tender offer and is thus geared towards controlled-transfer form of squeeze-out. It does not deal with the possible oppression by the minority in respect to supermajority controlling

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<sup>75</sup> (1953) 2 S.C.R. 204

<sup>76</sup> *Sammel v President Brand Gold Mining* supra (n8) at 633

<sup>77</sup> See chapter 2 2 2

shareholders who to the benefit of the company as whole should be allowed to squeeze-out a small percentage minority shareholders.



## 4 FUNDAMENTAL TRANSACTIONS SQUEEZE-OUTS: SCHEME OF ARRANGEMENT AND STATUTORY MERGER

### 4.1 Introduction

The definition of a fundamental transaction is not provided in the Act however it can be commonly defined as transactions that fundamentally alter the company. The Act provides for three types of fundamental transactions being a disposal of all or greater part of the assets or the undertaking of a company, an amalgamation or merger and a scheme of arrangement.<sup>78</sup>

The compulsory acquisition of minority shareholding can be utilised in terms of these transactions by means of a statutory merger or scheme of arrangement. In these transactions the terms of the transaction may be to provide some form of consideration for minority shareholders other than equity in the newly formed entity or resulting entity. Thereby the minority shareholders can be squeezed-out of the company because the said transactions can be effected by a special resolution<sup>79</sup> (in terms of authority) and as such there may a situation where the affected minority shareholder may vote against the resolution but still be bound by the terms of the resolution.

In the disposal of the all or greater portion of the assets transaction, the company may be fundamentally altered however it does not provide a manner whereby minority shareholders are offered consideration for the compulsory acquisition of their holding and effectively squeezed-out of the company.

The sell out right in fundamental transactions is the dissenting shareholder appraisal rights mechanism.<sup>80</sup> Effectively minority shareholders who vote against a fundamental transaction resolution may force a company, subject to the requirements of the applicable provision, to acquire their shares for a fair value to be determined judicially.

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<sup>78</sup> See s112-114 of the Act

<sup>79</sup> See s 115(2) of the Act

<sup>80</sup> See s164 of the Act

In this chapter we will illustrate how the scheme of arrangement and the statutory merger can be utilised as a squeeze-out device. We will also show the safeguards for affected minority shareholders and the right of recourse. In respect of the appraisal right it will be shown that it is not merely an exit mechanism but also serves other objectives in respect of the protection of minority shareholders.

## 4.2 Scheme of Arrangement

A scheme of arrangement is an agreement or arrangement between a company and holders of any class of securities in that company. The arrangement is proposed by the board of the company and is then subject to the requirements set out in applicable provisions. The Act sets out the various forms that the arrangement may be in terms of following:

- a) a consolidation of securities of different classes*
- b) a division of securities into different classes*
- c) an expropriation of securities from holders*
- d) exchanging any of its securities for other securities*
- e) a reacquisition by the company of its securities*
- f) a combination of the above methods<sup>81</sup>*

As set out above the Act makes specific provision for the squeeze-out right in that the arrangement may take the form of an expropriation for securities from holders. If all the requirements as set out in the Act for a scheme of arrangement<sup>82</sup> are met then the arrangement becomes binding on all the shareholders or the relevant class of shareholders and on the company by virtue of the special resolution.

The scheme of arrangement has been an attractive for acquirers who wanted to obtain full control of a target company in terms of the previous company act in South Africa.<sup>83</sup> The reason being that there was no quorum requirement to effect the transaction however different to the new dispensation the scheme of arrangement was required to have court approval. The essential requirements for the special resolution

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<sup>81</sup> See s 114(1) of the Act

<sup>82</sup> Will be discussed hereunder

<sup>83</sup> See s311 of the 1973 Act

could be achieved with greater ease than by trying to achieve the tender offer squeeze out threshold of 90 per cent acceptances.<sup>84</sup> Cassim provides an illustration of this form of transaction being the following:

*‘Offeror A could propose a scheme of arrangement between company B and its members in terms of which the members were paid a scheme consideration of R10 per share. Assume that the court application for the leave to convene a scheme meeting was granted and that the scheme of arrangement was approved at the scheme meeting by 75 per cent of the scheme members present and voting (Note that the approval of, for example, 75 per cent of 50 per cent of the company would be sufficient if only per cent of the shareholders attended the meeting or were represented there. This amounts to approval by 37.5 per cent of the company). If the court then sanctioned the results of the scheme meeting and the order was duly registered, the rest of the shareholders (in this example 62.5 per cent-being those who either attended the meeting and abstained or voted against the scheme, as well as those who did not attend) would be bound by the scheme in terms of the 1973 Act. Thus they would be forced to part with their shares at R10 per share – in essence an expropriation of their property authorised by 37.5 per cent of the shareholders of the company. In this way the offeror could acquire 100 per cent of the shareholding in the company.’*<sup>85</sup>

The use of the scheme of arrangement as a take-over mechanism and specifically as mechanism that allow a form of expropriation has been debated in South African case law.<sup>86</sup> In the matter of *Ex Parte Mielie-Kip Ltd*<sup>87</sup> Fleming J dealt with the issue

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<sup>84</sup> See s440K of the 1973 Act

<sup>85</sup> Cassim op cit (n28) at 727 -728

<sup>86</sup> In *Ex Parte Natal Coal Exploration* 1985 (4) SA 279 (W), the court held that expropriation of rights of a shareholder (ie where a shareholder receives a sum of money as compensation) is, no matter how fair the assessment of the compensation, a concept which falls outside the legitimated sense of the term „arrangement“ in the context of the statute. In *Ex Parte Suiderland Development Corporation* 1986 (2) SA 442 (C) it was held that expropriation in that context can be considered an arrangement. See also Cassim op cit (n28) at 728.

<sup>87</sup> 1991 (3) SA 449 (W) at 453-454

whether the expropriation of shares can be considered a scheme of arrangement in terms of the 1973 Act and stated the following:

*'I have difficulty with the rhetorical question in the minority judgment as to why an agreement for the sale ('expropriation') of shares should not be an arrangement. The expected answer remains without reasons. The positive question as to why it should be an arrangement is the appropriate question. There is no reason why an offer from A to obtain the shares of B against remuneration (which would result in a sale but with 'expropriation' coming in from the point of view that it may become binding even if B refuses the offer, other shareholders being in a position by the requisite majority to veto his refusal) would be an arrangement 'between' the company and the seller. It in no way affects the existence, scope or content of the relationship between the company and the member. What flows from being the registered holder of a specific share is unchanged. In that respect, already, the arrangement is not with the company or between the company and its member. A sale, compulsory sale, expropriation, and the like furthermore only changes the riders and not the qualities of the reins which link the rider with the horse. The company is relative to the nature of the transaction an unnecessary party if the reins are merely handed over. Unnecessary 'joining' in the transaction in terms of the words used or the form of the contract should not influence the substance: a purchase of shares with complete consent or with majority consent is not an arrangement between the company and its members, but between offeror and offerees. It must be remembered that it is not the word 'arrangement' which should be interpreted. A complete phrase is under consideration.'*

This issue seems to be resolved by the legislature by specifically including the words „an expropriation of securities from the holder.“<sup>88</sup> The scheme of arrangement is then without doubt a mechanism in order to squeeze-out minority shareholders.

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<sup>88</sup> See SM Luiz „Some Comments on the Scheme of Arrangement as an “Affected Transaction” as defined in the Companies Act 71 of 2008, PER/PERJ2012 Vol 15 No 5 at 106/638:

*'The purpose of listing the possible elements that may be included as part of a scheme of arrangement is to put to rest most of the debates that have occurred in the context of the interpretation of section*

The requirements to effect a scheme of arrangement is the same for fundamental transaction that will be discussed together. There are certain exceptions that will be highlighted.

### 4.3 Statutory Merger

As stated above the Act has introduced a new concept to the South African corporate legal framework being the statutory merger. The broad definition of a statutory merger is the assets and liabilities of two or more companies are pooled in a single company that may either be a new company or a surviving company of the transaction.<sup>89</sup> This form of transaction can be utilised as a squeeze-out mechanism whereby the minority shareholders receives a cash or other consideration, but not equity in the merged entity, in exchange for their shares in either one of the previous entities. The ability to use the statutory merger to squeeze-out device would thus depend on the possible limitation on the consideration paid in respect of a merger.

It seems the Act has taken a liberal approach in this regard by not limiting the manner in which consideration (other than equity in the merged entity) is given in a merger transaction.<sup>90</sup> The principal idea of paying cash consideration to the shareholders of

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*311 (the scheme of arrangement provision) under the Companies Act 1973. Those centered on issues such as whether shareholders could have their shares expropriated in exchange for cash or whether an arrangement meant that the shareholders' interests could be altered but not altogether extinguished.'*

<sup>89</sup> Cassim op cit (n28) at 676

<sup>90</sup> See s113(2) of the Act whereby the legislature sets out the possible terms of the merger agreement and specifically at s113(2)(b) makes provision for consideration in lieu of securities in the merged company but no limitation on what that consideration can be. See also 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* at 345 : ‘There also is nothing in the section, which prevents or limits the payment of a cash consideration. The ability to pay cash consideration in the context of a merger is not without controversy, particularly given the possibility that it may be used as a mechanism to expropriate or ‘freeze out’ minority shareholders, and indeed certain jurisdictions place a limitation on the proportion of the consideration which may be in cash. Nevertheless, a number of jurisdictions, including the United States and Canada, allow for the payment of cash consideration. It would also be

the disappearing company is that shareholders do not have a vested right to continue to hold their investment as shareholders of the surviving merged entity but could instead be cashed out.<sup>91</sup> It can thus be used to eliminate minority shareholders, which is also known as a freeze out merger.

A further distinction relating to mergers is an arm's length merger and an interested merger. In a arm's length merger the acquiring party does not have equity interest in the target company whereas in a interested merger the acquiring party does have a equity interest in the target company and is usually the majority or controlling shareholder. It can thus be said that an arm's length freeze out merger is a controlled-transferred squeeze-out transaction whereas the interested party.

#### 4 4 The Regulation of Squeeze-Outs in Fundamental Transactions

In this section the regulation of scheme of arrangements and statutory mergers in the context, as squeeze out mechanism will be analysed. The most important aspect will be whether there is sufficient protection and fair treatment of the affected minority shareholders. As mentioned above the Act provides for a dissident shareholder appraisal mechanism, this will be viewed as a sell-out right however it also provides further aspects in respect to minority protection that will be discussed. The emphasis here will be to analyse the prerequisites of the applicable fundamental transactions as suitable safeguards for the said minority as well as the right to recourse by a minority on alleged unfair squeeze-out transactions. A comparative analysis will be done of the identifies safeguards against those which have been used in applicable jurisdiction being the United States regulation of the long form merger and in particular in the State of Delaware, in order to assess whether the statutory safeguards to freeze-out mergers are adequate.

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*possible for a buyer to offer a mix of cash and share consideration, which might be a fixed blend of x shares and y rand per target company share or could be structured to allow target shareholders to choose cash or shares (with a mechanism to prorate the oversubscribed form of consideration).'*

<sup>91</sup> Cassim op cit (n28) at 709

#### 4 4 1 Statutory Prerequisites

Both forms of applicable fundamental transactions being the scheme of arrangements and statutory merger have similar statutory prerequisites. There however two notable exceptions to this statement.

In a statutory merger the boards of each merging companies is required to perform a solvency and liquidity test as prescribed in the Act.<sup>92</sup> The boards must be satisfied that upon implementation of the merger agreement both or all the entities will be pass the solvency and liquidity test as prescribed in the Act. This is not a prerequisite for implementing a scheme of arrangement, however if the scheme involves the repurchase of shares by the company.<sup>93</sup> The purpose of the solvency and liquidity is for the protection of amongst others the creditors and shareholders of the company and will thus not be applicable as a protection measure for the shareholders who will be squeezed-out.

In a scheme of arrangement the company is required to retain an independent expert who must compile a report which must amongst other identify the holders of securities who are affected by the proposed scheme and evaluate the material adverse effects against the compensation received by those persons in terms of the scheme.<sup>94</sup> This can thus be viewed as a safeguard provided to affected shareholders in the case of expropriation of shares. The use of an independent expert and report is also applicable to statutory mergers in certain instances. If in statutory merger one of the merging companies is a regulated company there must be request for a ruling made to the Takeovers Panel whether or not an independent expert must be retained for the proposed merger.<sup>95</sup> The said independent expert must compile a report which should also include the requirements for the said report for a scheme of arrangement, as well other requirements as set out in the applicable regulation mainly relating to valuation

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<sup>92</sup> See s113(4) read with s4 of the Act

<sup>93</sup> See Luiz op cit (n88) at 113/638 to 116/638

<sup>94</sup> See s114(2) & (3) in particular s114(3)(b)-(d) of the Act

<sup>95</sup> See reg90 read with s117(1)(c)(ii) of the Act

of the transaction.<sup>96</sup> The report must also contain an opinion on the fairness and reasonableness of the offer considerations on the affected holders of securities.<sup>97</sup>

There is a further regulatory burden on transactions involving regulated companies as mentioned above. The companies that are not regulated companies are private companies that have not transferred 10 per cent of its issued securities, other than to related or inter-related, within 24-month period. The objective of this provision is recognition that in the initial start-up phase of a private company the burden of compliance with applicable provisions in the Act and Regulations, in many instances be unduly harsh on a private company.<sup>98</sup>

A significant aspect of, the solvency and liquidity as well as the independent expert provisions are that they contain mandatory disclosures to all holders of securities.<sup>99</sup> These disclosures must include shareholders appraisal rights and requirements of a fundamental transaction as set out in s115 that will be discussed hereunder.

The common statutory prerequisites for fundamental transactions are provided for in s115 of the Act. The most important aspect of this provision is the authority for the approval of a fundamental transaction in terms of a special resolution. The special resolution required is however different to the normal special resolution provided in the Act, as it must comply with certain further requirements.<sup>100</sup> If the transaction is not approved in the manner provided in the provision it may not be implemented at all.

The special resolution requires a meeting, which the quorum is constituted by at least 25 per cent of all the voting rights are entitled to be exercised on that matter.<sup>101</sup> Notably the MOI may not decrease the quorum requirements but can increase the requirements. The special resolution requires the support of at least 75 per cent of the

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<sup>96</sup> See reg90(2)

<sup>97</sup> See reg90(6)(c)

<sup>98</sup> See para 2.3 of Guideline 3/2011 of the Takeover Regulations Panel

<sup>99</sup> See s 113(5) and 114(3) of the Act

<sup>100</sup> See s115(1) of the Act

<sup>101</sup> See s115(2)(a) of the Act



voting rights actually exercised on the resolution. It can further be deduced from the wording of the relevant provision that the MOI cannot contain a decrease or increase in the required voting approval for the said special resolution.<sup>102</sup> The 75 per cent threshold is apparently fixed and cannot be altered.

The most important development in respect to protection afforded for affected minority shareholders is that any voting rights controlled by the acquiring party, or person related to an acquiring party, or persons acting in concert with the acquiring party is disqualified for purposes of the voting and calculating the quorum in respect to the said special resolution.<sup>103</sup> This is an important protection for the affected minority shareholders and is also known as the „majority-of-the-minority-vote.“ The purpose of this exclusion is most likely to prevent a situation as illustrated in using the scheme of arrangement as a squeeze out mechanism<sup>104</sup> whereby there is a possibility unfair expropriation of minority shareholders. As will be discussed further the „majority-of-the-minority-vote“ is used as a protection tool in freeze out mergers in the US jurisdiction.

One of the main features of the new Act is that court approval for fundamental transactions is not mandatory. This feature is based on the premise that where the proposed fundamental transaction has been approved by the requisite votes, the dissenters are not allowed to approach the courts in order prevent or frustrate the transaction. This is main shift from the 1973 provisions that required a two court approvals to implement a scheme of arrangement.<sup>105</sup> The new provision does however provide court approval where the special resolution was opposed by at least 15 per cent of the voting rights and on application of a shareholder who voted against the resolution.<sup>106</sup> Court approval may also be required if a shareholder who voted against the resolution and was granted leave by the court.<sup>107</sup>

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<sup>102</sup> See s115(1) of the Act and Cassim op cit (n28) at 690

<sup>103</sup> See s115(4) of the Act

<sup>104</sup> See at 4 2 the Cassim op cit (n28) illustration of using the Scheme of Arrangement mechanism to gain 100 per cent control in terms of the 1973 Act.

<sup>105</sup> See s311 of the 1973 Act

<sup>106</sup> See s115(3)(a)

<sup>107</sup> See s115(3)(b) read with s115(6)&(7)

There is no automatic right to recourse provided to a disgruntled shareholder and can only require the resolution to be reviewed by the court if firstly the shareholder was granted leave by the court. The provision is also silent on whether the court in reviewing the resolution may grant an order amending the terms of the resolution as provided in the right of recourse in a tender offer squeeze-out.<sup>108</sup> The grounds on which a court can set aside a resolution is also narrow being if it is manifestly unfair to any class of shareholders, tainted by conflict of interests, inadequate disclosures, failure to comply with the Act, MOI, rule or material significant procedural irregularity.<sup>109</sup>

It is clear from this provision that it is the intention of the legislature to only allow court intervention where it is absolutely necessary. This liberalisation may be welcomed but has raised concerns amongst commentators taking into account the possibility of squeezing-out or freezing-out minority shareholders by implementing fundamental transactions.<sup>110</sup> Taking into account the limited recourse or court involvement further minority protections in this form of squeeze-outs should be investigated. In order to determine the said protection I will look at similar jurisdictions in respect to the applicable provisions of the Act.

#### 4 4 2 Freeze-Out Long Form Merger Regulation in the Delaware Jurisdiction

The purpose in doing a comparative analysis on the Delaware jurisdiction is that it also provides for freeze-out mergers without prior court approval. The said jurisdiction provides for long form mergers<sup>111</sup> and so called short form tender offer

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<sup>108</sup> See s124(2)(b)

<sup>109</sup> See s115(7) of the Act

<sup>110</sup> See Cassim op cit (n28) at 714: *'Needless to say, the majority-of-the-minority-vote is a necessary but not a sufficient protection for the minority shareholders in a freeze-out merger. Further effective minority-protection measures are required. These will no doubt in due course form part of the fiduciary duties of directors as developed by the courts, and also form part of the new Takeover Regulations.'*

<sup>111</sup> See S251 of the DGCL

mergers.<sup>112</sup> In this analysis I will focus on the long form mergers as the short-form mergers fall under supermajority types squeeze outs that will be discussed in chapter five. The long form merger is similar to the South African statutory merger procedure.

In Delaware a freeze-out merger is typically executed where the controlling shareholder establishes a wholly owned company, the target company's board (typically dominated by the controller) approves the merger and the shareholders target company (also dominated by the controller) approves the transaction. Under the terms of the merger, the minority shareholders receive either cash or the controller's shares in exchange for their shares in the target company. The transaction is executed as a statutory merger under section 251 of the Delaware General Corporation Law.<sup>113</sup> In determining further minority shareholder protection in these transactions we will examine how courts of Delaware dealt with this issue.

The main standard of review in United States corporate law is the business judgment rule. This standard is predicated on the principle that the business affairs a company are managed by or under the direction of the board of directors.<sup>114</sup> In terms of this right the business judgment rule requires courts to defer to business decision as long as those decisions comply with the board's fiduciary duties of loyalty, due care and good faith. The business judgment rule thus shields the directors from legal liability if they performed their duties diligently and carefully. The rule is thus both a procedural and substantive rule. In the context of procedural it places a burden of proof on the plaintiff to overcome the court's presumption that the directors have acted within their fiduciary duties. The substantive element limits the directors' liability to only decision not made within their fiduciary duties.<sup>115</sup>

If however a plaintiff can rebut the presumption that the business judgment rule is not applicable then the standard of review of the board's decision is the „entire fairness“

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<sup>112</sup> See S253 of the DGCL

<sup>113</sup> Subramanian op cit (n18) at 9.

<sup>114</sup> See *Mcullin v Beran* 765 A.2d 910, 916 (Del. 2000)

<sup>115</sup> See F Balotti & J Hanks „Rejudging the Business Judgment Rule 48 Bus Law 1337, 133-40 (1993).

standard of review. Under the entire fairness review the burden of proof shifts to the defendant directors to show that the challenged transaction both resulted from a fair dealing process and represents a fair price. The standard of review is thus of significance for shareholder litigation.<sup>116</sup>

In shareholder litigation challenging freeze-out merger transactions Delaware courts established that such transactions would be subject to the entire fairness standard of review. This was due to the general approach to self-dealing transactions.<sup>117</sup>

In dealing with this form shareholder litigation by applying the entire fairness review the courts stated various minority shareholder protection mechanisms that could have been utilised which would have resulted in fair dealing of the transaction. One such mechanism was the target company establishing a special committee of independent directors to assess and negotiate with the acquirer or controlling shareholder on behalf of the affected minority shareholders. The Delaware Supreme Court, in the matter of *Weinberger v UOP*, first introduced this mechanism.<sup>118</sup>

The *Weinberg* matter involved a freeze-out of UOP's minority shareholders by its 50.5 per cent shareholder, Signal. The court in applying the entire fairness found several issues including conflict of interests in preparation of the valuation reports and casualness of the fairness opinion provided by the advisors to UOP's board. In dealing with these issues the court paused to note a possible mechanism to avoid these forms of unfair dealings whereby it stated:

*‘Although perfection is not possible, or expected, the result here could have been entirely different if UOP had appointed an independent negotiating committee of its outside directors to deal with Signal at arm’s length. Since fairness in this context can be equated to conduct by a theoretical, wholly independent, board of directors acting upon the matter before them, it is unfortunate that this course apparently was neither considered nor pursued.*

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<sup>116</sup> Pinta op cit (n42) 935 at fn 10 also see generally D Block, E Barton & S Radin „, *The Business Judgment Rule: Fiduciary Duties of Corporate Directors* (1998) 5<sup>th</sup> Ed

<sup>117</sup> Subramanian op cit (n18) at 9

<sup>118</sup> 457 A.2d 701 (Del 1983)

*Particularly in a parent-subsidary context, a showing that the action taken was as though each of the contending parties had in fact exerted its bargaining power against the other at arm's length is strong evidence that the transaction meets the test of fairness.*' <sup>119</sup>

The use of the mechanism of a special committee of independent directors negotiating at an arm's length became standard practice in concluding freeze-out mergers.

A further mechanism was identified in the matter of *Rosenblatt v Getty Oil Co.*<sup>120</sup> being the approval of the majority of the minority shareholders ( 'the MOM condition' ). In that matter after extensive negotiations between the parties to a freeze-out merger proposal, the final proposal was presented to the shareholders. In the vote 89 per cent of the minority shareholders, representing 58 per cent of all the minority shares, approved the transaction. The deal was finalised and the minority shareholders fairness claim in the Delaware Chancery Court. The chancery court found the deal to be fair and it was subsequently appealed. The Delaware Supreme Court dismissed the appeal however further found that the approval by the minority shareholders shifted the burden on entire fairness to the plaintiff but not change the standard of review to that of the business judgment rule.<sup>121</sup>

The result of these judgments was that, in the event of a freeze-out merger, if either the MOM condition or special committee of independent directors was employed before the deal was finalised the burden of proof of the entire fairness review shifted on the plaintiff minority shareholder.

In the recent judgement of *In re MFW Shareholders Litigation*<sup>122</sup> the court made a major development in respect of the steps required during the conclusion of a freeze

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<sup>119</sup> Weinberg supra (n118) at 709

<sup>120</sup> 493 A.2d 929 (Del.1985)

<sup>121</sup> Subramanian op cit (n18) at 16

<sup>122</sup> 67A. 3d 496, 502 (Del. Ch 2013)

out merger. In that matter MacAndrews & Forbes a holding company whose equity is solely owned by defendant Ronald Perelman owned 43 per cent of M&F Worldwide (MFW). MacAndrews & Forbes offered to purchase the rest of the corporation's equity in a freeze-out merger for \$24 per share. But upfront, MacAndrews & Forbes said it would not proceed with any going private transaction that was not approved: by an independent special committee and by a vote of a majority of the stockholders unaffiliated with the controlling stockholder.

The court found that by employing the both the protection mechanisms of the special committee of independent directors and the MOM condition the standard of review changes from the entire fairness review to that of the business judgment rule standard of review. This was a landmark decision in that the court recognises that by employing both sets of protection methods the minority is sufficiently protected and that recourse should be limited to only when there was a breach of a fiduciary duty. The mechanisms are therefore only really effective when used in tandem and not as substitutes.<sup>123</sup>

This is an important development in the protection of minority shareholders by placing a fiduciary duty on directors and allowing minority shareholders an opportunity to approve a transaction without being coerced.

#### 4 4 3 Dissident Shareholder Appraisal Right

As stated earlier the dissident shareholder appraisal right is a means whereby the minority shareholder upon a certain triggering event can force the company to

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<sup>123</sup> See MFW Judgement supra (n122) at 8 where Chancellor Strine held:

*A special committee alone ensures only that there is a bargaining agent who can negotiate price and address the collective action problem facing stockholders, but it does not provide stockholders any chance to protect themselves. A majority-of-the-minority vote provides stockholders a chance to vote on a merger proposed by a controller-dominated board, but with no chance to have an independent bargaining agent work on their behalf to negotiate the merger price, and determine whether it is a favorable one that the bargaining agent commends to the minority stockholders for acceptance at a vote. These protections are therefore incomplete and not substitutes, but are complementary and effective in tandem.*

acquire its shares at a fair value. The triggering events is a proposed fundamental transaction or a proposed amendment of the MOI and the shareholder must vote against the proposal also further comply with other statutory requirements.<sup>124</sup>

There are three main underlying objectives of the appraisal remedy. The first is an exit mechanism for the shareholder who as result of fundamental change in his investment (the triggering events) must comply with the majority of the shareholders by virtue of the special resolution. The mechanism thus provides that he be cashed out on fair value of his holdings and is thus not subject to the majority if it would fundamentally alter his or her investment.

The second objective is to remedy for unfairness, where the minority shareholders believe that the price offered for their holdings do not at least represent a fair value of those shares. In this way the said shareholders are provided an alternative means to challenge the price offered.

The third objective is that the appraisal rights serve as a deterrent for unfair decisions in respect to the fundamental transactions or amendments of the MOI. This entails that even if they can pass the resolution that can possibly unfair on some shareholders those shareholders can invoke their appraisal rights that the company would want to avoid and thus prevent from making unfair decisions in the first place.<sup>125</sup>

In theory the appraisal rights would serve as a counter balance for compulsory acquisitions made by the controlling shareholder or outside acquirer, however there are certain flaws in this theory. Firstly the dissident shareholder that is subject to strict statutory requirements must initiate the appraisal right. The appraisal right should thus be seen as an additional form of regulation of squeeze-outs but should not be utilised as sole forms of regulation to protect affected minority shareholders.

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<sup>124</sup> s164 of the Act

<sup>125</sup> Cassim op cit (n28) at 797

## 4 5 Conclusion

The Act has introduced new innovations in the field of South African takeover, the objective of which is to balance the encouragement of economic activity and prudent risk-taking with appropriate protections for the interests of all company stakeholders.<sup>126</sup> In this section there is an attempt answer whether the minority shareholders are adequately protected in these transactions because the mandatory court approvals have been jettisoned in lieu for further statutory or regulatory minority protection mechanisms. The question has been raised in respect to the extent whereby the directors owe a fiduciary duty to the minority shareholders in the event of the discussed transactions.<sup>127</sup> It is however argued that the duty owed should not be limited to information but that there should be a positive duty on directors to bargain on behalf of shareholders. This section will thus argue that the said duty is owed to the minority shareholders in the context of the best interests of the company by way of employing the arms-length approach to fundamental transactions.

The minority protection to be employed in these transactions should be based on three principles all in the context of an arms length approach. The first being there should be sufficient disclosure made in respect to these transactions. The second being, that there should be a fiduciary duty on the board towards the minority shareholders to enable them with bargaining power in respect to the transaction. The third aspect is that the minority must approve the transaction and not be coerced by the controlling shareholder.

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<sup>126</sup> Davids op cit (n90) at 334

<sup>127</sup> See Cassim op cit (n28) at 701: ‘*The Act does not explicitly require any information to be furnished to the shareholders nor does it require the directors to give any advice or recommendations to the shareholders. However, the directors’ fiduciary duties may well require more of directors. It is submitted that the fiduciary duties of directors would for instance, require the directors to honestly and objectively consider whether the merger, including the terms and conditions of the merger consideration, is in the best interest of the company. In some circumstances, it may be appropriate for directors to furnish shareholders with a report by an independent expert on the merits of the proposed merger. The new Takeover Regulations (insofar they are applicable to the company) also supplement the role of the board of directors.*’



In respect to disclosure the Act has provided sufficient safeguards by in respect of schemes of arrangements the employment of an independent expert required to provide a report and in terms of statutory mergers involving a regulated company. This ensures that the minority have ability to assess the findings of an independent expert and the report provided must comply with the statutory and regulatory requirements.

The takeovers regulations do also require an independent board opinion of an offeree, regulated company (after taking into account the fair and reasonable opinion supplied by the independent expert). This opinion must then be communicated to the holders of securities in the offeree company that would be affected by the offer.<sup>128</sup> The difference between this procedure and the requirement of a special committee of independent directors in the Delaware Jurisdiction is the ability to bargain on behalf of the affected shareholders. The South African takeovers regulations provide for a board opinion that is disclosure provided to the affected shareholders.

The second aspect is to provide the affected minority shareholders with some form of arm's length bargaining power. This can be achieved by the employment of the target company's board of directors to establish a special committee with the ability to veto a transaction if it is not on fair terms. In doing so the directors of a company will have to owe a fiduciary duty to the minority shareholders in certain instances which have not been a feature of the South African corporate legal framework. In order to ensure that there is no conflict of interests and by keeping the process at an arm's length the board should establish a special committee of independent directors and the requirements of this independence should be contained in the takeover regulations.

The Act sufficiently provides for the authority of the said transactions by a majority of the minority format in terms of the required special resolution. This is an adequate protection mechanism in terms of the principle of arm's length unforced approval.

The Act also provides for an appraisal right to affected shareholders. It should however be remembered that it should be considered as a right to the minority shareholder and not as regulation of the said transaction.

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<sup>128</sup> Luiz op cit (n88) at 113/639; also reg 110

## 5 SUPERMAJORITY SQUEEZE-OUTS

### 5.1 Introduction

This form of squeeze-out enables a majority shareholder, once he has obtained a supermajority threshold in a target company to squeeze out the remaining minority shareholders. The difference for this type and the tender-offer type is that the threshold is set at a certain holding of securities whereas the tender offer type requires a threshold in respect to the number acceptances given for an offer. The two types are similar in that in most cases they involve the same two-step transaction and can be used after the tender offer. As stated the critical difference is that the supermajority type is a pure form of controlled maintained form of squeeze-out mechanism. Once the certain level of threshold is obtained it is in the power of the board of the company to squeeze out the remaining shareholders subject however to further statutory or regulatory requirements.

This form of squeeze-out is not provided for in the Act, as jurisdictions either have a tender offer type or a supermajority type of squeeze-out right. In this chapter the forms of supermajority squeeze outs used in the Delaware, German and New Zealand jurisdictions will be illustrated. A case will be made for the inclusion of a supermajority type of squeeze-out mechanism in the South African law as a result of issues arising out of the interplay of certain sections of the Act that can possibly prevent a supermajority owner of the ability to squeeze-out minority shareholders.

### 5.2 United States Jurisdiction: Short-Form Merger

In most of the leading commercial states in the US the statutes allow a majority shareholder with high enough ownership or shareholding, in Delaware and California for example a 90 per cent threshold is required,<sup>129</sup> to approve a merger without a vote of the target company shareholders, although the target shareholders may exercise appraisal rights following the transaction.<sup>130</sup> These form of mergers are known as

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<sup>129</sup> See s 263 of the DGCL and s 1110(b) of the California Corporation Code

<sup>130</sup> Gilson op cit (n35) at 1253

„tender offer freeze-outs“ in that they usually happen in a two part transactions the first being the tender offer in order to obtain the threshold holding.

The critical difference between a tender offer and the short form merger is the threshold required in order to enact the transaction. The short form merger threshold refers to the ownership of all outstanding shares in the target company<sup>131</sup> whereas the tender offer squeeze out related to the threshold of acceptances of the shares that the offer relates to. The procedure to effect a short form merger in terms of s 253 of the DGCL is as follows: The board of directors of the parent company adopts a resolution providing for the merger and a „certificate of ownership and merger“ is filed with the Secretary of State setting forth the fact that the parent owns at least 90 per cent of the outstanding shares of each class of securities otherwise entitled to vote upon a merger of each of the subsidiaries involved and attaching a copy of the resolution. An agreement of merger is not used. The merger is effective upon filing of the certificate.<sup>132</sup>

The merger is thus a unilateral act by the directors of the holding company. The 90 per cent ownership applies only to classes that would be able to otherwise vote on the merger.<sup>133</sup> The process of determining the consideration terms begins when the controller informs the target board of its intention to freeze out the minority, and the target board responds by establishing a Special Committee (SC) of independent directors. The difference between the SC in long form mergers is that in long form mergers the SC has the power to can veto the transaction and in theory negotiate with the controller indefinitely. The SC of in a short form merger cannot veto a proposed

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<sup>131</sup> See s263 of the DGCL which provides: *In any case in which at least 90% of the outstanding shares of each class of the stock of a corporation or corporations (other than a corporation which has in its certificate of incorporation the provision required by § 251(g)(7)(i) of this title), of which class there are outstanding shares that, absent this subsection, would be entitled to vote on such merger, is owned by another corporation and ...*

<sup>132</sup> RF Balotti & JA Finkelstein „The Delaware Law of Corporation & Business Organizations“ 3<sup>rd</sup> ed (2009) at 9-34

<sup>133</sup> EP Welsh, AJ Turezyn RS Saunders „Folk on the Delaware General Corporation Law: Fundamentals“ 2015 Ed (2015) at 868

merger but must provide a recommendation<sup>134</sup> whether to approve or not approve a merger within ten days.<sup>135</sup>

The recourse provided to minorities to challenge the fairness of a proposed transaction is also different because the review is always on the standard of business judgement rule. It has been held that in short form mergers the minorities that „absent fraud or illegality, appraisal is the exclusive remedy available to a minority shareholder who objects to a short form merger.“<sup>136</sup> This is different from the statutory merger grounds for establishing the standard of review.

### 5.3 German Jurisdiction: Expulsion of Minority Shareholders

The German jurisdiction provides for a squeeze out procedure based on a supermajority holding of a certain threshold registered share capital. This is known as the expulsion of minority shareholders procedure.<sup>137</sup> The squeeze-out procedure, is not paralleled by any right of withdrawal and is not contingent on the making of a takeover bid as is the corresponding right in the tender offer squeeze-out mechanism.<sup>138</sup>

According to §327a of the German Stock Corporation Act, the general meeting of a public limited liability company or a limited partnership with shares may, at the request of a shareholder who holds 95 per cent of the companies in capital, resolve that the shares of the other (minority) shareholders be transferred to the majority shareholder as against appropriate compensation. In determining the 95 per cent threshold the holder must control 95 per cent of the of the registered share capital, and does not include shares held by the company itself.

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<sup>134</sup> Known as a Schedule 14D-9 recommendation in terms of Section 14(d)(4) of the 1934 Securities Exchange Act.

<sup>135</sup> Subramanian op cit (n18) at 22

<sup>136</sup> In re Unecol Exploraation Corporation Shareholders Litigation A.2d 329 (Del. Ch. 2000), Glassman v Unecoal Corporation 777 A.2d 242 (Del.Ch.2001)

<sup>137</sup> See §327a-327f of the German Stock Corporation Act (*Aktiengesetz*) also G Wirth M Arnold R Morshauer M Greene „Corporate Law in Germany“ 2nd Ed (2002) at 545 – 548.

<sup>138</sup> See F Wooldridge The New German Takeover Act“ 14 Eur Bus L Rev (2003) at 84

The majority shareholder does not have to hold the shares in person, for the purposes of determining, whether 95 per cent of the shares belong to the majority shareholder. Accordingly, the following shares will be imputed to the majority shareholder: Shares held by (other) undertakings if such undertakings are controlled by the majority shareholder. Shares held by other undertakings on account of the majority shareholder; and If the majority shareholder is a sole proprietorship, shares which belong to the other property of such one-man-business. The law does not provide for special requirements to be met by the majority shareholder as such. Everyone who can be the bearer of rights can be a majority shareholder. Therefore, natural persons are comprised as well as legal persons, whether based on private or public law, associations of persons that can be bearers of rights as well as foreign entities.<sup>139</sup>

The compensation is determined by the majority shareholder, who must be given the necessary information and documents by the executive board. The compensation is based on the market price of the shares.

The „squeeze-out“ takes effect once the resolution is entered in the Commercial Register. The resolution providing for it cannot be avoided on the ground that the majority shareholder has attempted to gain special benefits for himself, or that the compensation to be given is inadequate. However, application may be made by any minority shareholder to the competent court for the purpose of fixing such compensation.<sup>140</sup>

#### 5 4 New Zealand Jurisdiction: Dominant-Owner Squeeze-Out

In the New Zealand corporate framework there are code companies, which are companies that are registered Companies Office Register of New Zealand Companies. If a corporate entity is not registered on that Companies Office Register, then it is not a Code Company. For example, unit trusts and overseas companies are

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<sup>139</sup> See S Simon F Schaumberg „Germany Squeeze-Out Guide IBA Corporate and M&A Law Committee 2010“ available at <http://www.ibanet.org/Document/Default.aspx?DocumentUid=FFD62DFD-8004-4D14-8BF2-06DFA126893A> accessed on 1 September 2015.

<sup>140</sup> Woolridge op cit (n138) at 84

not Code Companies. In addition to being a New Zealand registered company, in order to meet the threshold of being a Code Company the company must have (or recently have had) listed shares that trade on the New Zealand Exchange or have 50 or more shareholders who hold Voting Rights (i.e., ordinary shares).<sup>141</sup>

The Takeovers Code regulates the procedures for changes of control of Code Companies. The Takeovers Code includes rules for Compulsory Acquisition of the Shareholders' shares. Compulsory Acquisition means that a Shareholder (or two or more Shareholders acting together) who owns at least 90 per cent of all the shares can (or must) buy all of the rest of the shares. The Takeovers Code has rules about the price that has to be paid for these shares. A Shareholder who reaches the 90 per cent threshold in a Code Company is called a „Dominant Owner“.<sup>142</sup>

In achieving the dominant owner status the shareholder obtains a general right to obtain all the shares in the code company, as well as the minority shareholders have the right to sell their holdings to the major shareholders once he achieves the status as dominant owner.<sup>143</sup> This can be seen as a squeeze-out right and a sell-out right respectively as consequence of having a supermajority holding in a company.

The dominant owner has to notify the Code Company that the 90 per cent threshold was crossed. The Dominant Owner has to make a choice in respect to a compulsory sale and a voluntary sale. In a compulsory sale the Dominant Owner requires the remaining Shareholders to sell their shares to the Dominant Owner. A voluntary sale the Dominant Owner asks the remaining Shareholders if they want to sell their shares, and if they do want to sell their shares then the Dominant Owner has to buy them.

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<sup>141</sup> See s3A of the Takeovers Code Approval 2000 of New Zealand (the Code)

<sup>142</sup> See the definition at s50 of the code which states: *dominant owner, in relation to a code company, means a person who, after this code comes into force, becomes the holder or controller, or 2 or more persons acting jointly or in concert who, after this code comes into force, become the holders or controllers, of 90% or more of the voting rights in the code company (whether by reason of acceptances of an offer or otherwise)*

<sup>143</sup> See s 52 & 53 of the Code

An interesting aspect to this squeeze out mechanism is the calculation of the consideration payable to the affected minority shareholders in a compulsory sale. In this respect the code makes a distinction between the controller becoming a dominant owner by virtue of acceptances of an offer and by an alternative method.

In terms of Rule 56 if a person becomes a Dominant Owner by virtue of acceptances of an offer then the consideration to the remaining minority must be the same as in the offer provided it is an offer for equity securities in the same class. This only applies if the acceptances of the offer were received in respect of more than 50 per cent of the equity securities that were subject of the offer in the class which consideration is to be determined.

The code however also make provision for when a controller becomes a Dominant Owner by means other than in terms of a offer. In such a case determination of the consideration will then not be based on a offer. The consideration is then calculated as a cash sum certified as fair and reasonable by an independent adviser.<sup>144</sup>

The minority shareholders may object to the calculation in the prescribed written manner whereafter the dominant have to refer the calculation to expert determination in terms of Rule 57(3). The consideration in those circumstances will be a cash sum equal to the fair and reasonable value of those securities. The expert determination must be calculated by the value of all the equity securities in the class of equity securities of which the equity security forms part, and allocating that value pro rata on all the securities of that class. The expert determination, made by an independent person appointed by the Takeovers Panel, must make the determination within 28 days after his or her appointment.<sup>145</sup> The Dominant Owner must pay the costs of the expert determination. Upon receipt of the expert determination the dominant owner must send a copy of it to the Takeovers Panel, to the New Zealand Exchange (if the Code Company is listed), and on request to any other person within one day of receipt of such a request.<sup>146</sup>

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<sup>144</sup> Rule 57(1)(a) of the Code

<sup>145</sup> Rule 58 of the Code

<sup>146</sup> R Falvey MER Watts 'New Zealand Squeeze-out Guide IBA Corporate and M&A Law Committee 2010 available at:

## 5 5 Conclusion

An issue arises from the interplay of sections of the Act in respect to a dominant controller arising not from a tender offer to squeeze-out minority shareholders. The controller in such an instance should be able to squeeze-out the minority by means of a fundamental transaction however the requirements of such a transaction is special resolution whereby the controllers votes will not be considered. This may give rise to the possibility of the minority preventing the controller to become 100 per cent owner or make the target company a wholly owned subsidiary.

The alternative methods to achieve full ownership can be by amending the MOI in such a way to squeeze-out the minority shareholders. There will however be concerns with a direct squeeze-out by means of this method.<sup>147</sup>

An indirect method can be achieved from the consolidation of shares that can lead to the squeeze-out of minority shareholders, also by means of reverse stock split. This method is however regulated by the JSE Listing Requirements<sup>148</sup> and can possibly not work where there is a relatively large minority shareholding in this context.

The best method of addressing this issue will be an introduction of a supermajority squeeze-out method. As in terms of the New Zealand model it can work in conjunction with the tender offer type or as per the US model it can be further method of merger arrangement.

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*<http://www.ibanet.org/Document/Default.aspx?DocumentUid=55A33019-8456-479A-A14F-BE8D923DA3F2f>, accessed 1 September 2015.*

<sup>147</sup> It can lead to claims in terms of s165 of the Act relating to relief from prejudicial or oppressive conduct; also see *Gambotto v WCP Ltd* (1995) 182 CLR 432

<sup>148</sup> See „Odd Lot Holders“ JSE Listing Requirements Rule 5.124, 18.1(o)



## 6 CONCLUSION

The utility of a compulsory acquisition can best be illustrated through the application of the so-called going private transaction. The purpose of the going private transaction is for either the outside acquirer or controlling shareholder to make a public company private. In this way the controller takes the shares off the company off the market and can attempt to make the company more efficient in order at a later stage to sell the shares of a company on the market at a premium.

This has been the function of private equity funds and forms an important part of the corporate framework which investors expects from the said framework. It serves two fundamental purposes firstly it allows a party to attempt to make a company more efficient or valuable without the regulatory burden of a public company and secondly it allows it do so without the market being aware of this.

The compulsory acquisition provision ensures that such transaction is not impeded by an oppression of the minority shareholders by rejecting the proposed transaction. The said minority might not be able to prevent the transaction but can cause unnecessary impediments to complete the transaction. The said provision thus assists a party in finalising the transaction and where necessary assist to expropriate the shareholding of the small minority shareholders.

The aim of this dissertation was to analyse whether the devices provided in the South African corporate framework to utilise the abovementioned tool of compulsory acquisitions was adequate to achieve the objective of compulsory acquisitions. The regulation surrounding the said devices was further analysed in order to ensure the fair treatment of the affected minority shareholders.

In assessing the objective or basis of the compulsory it was found that it originated from the oppression of the minority in respect of takeover transactions that led to the codification of so called control-transfer squeeze-out devices. In further analysis it was found that justifications provided for theses devices can and should be afforded to controlling shareholders and not only outside acquirers of a company. The considerations are the same and through the development of minority shareholder

protection devices the squeeze out function should not be limited but also include control-maintained squeeze-out devices.

In determination of the justification and objective of compulsory the focus shifted to determine whether the devices provided achieved these goals. In analysing the three main forms of squeeze-out devices utilised in jurisdictions the following issues in the current South African corporate framework were identified:

*i) The 'class of shares' provision in the statutory tender offer squeeze-out*

The main objective of the compulsory acquisition provision is to provide the controller, or in the case of tender offer, the offeror if the threshold of acceptances was received to have full control of a company. The wording of the current s124 however provides that the squeeze-out provision can be utilised to acquire full control of a class of shares and not in terms all the shareholding of a company. It is noted that there are different values for different classes of shares and that some offers may only relate to a certain class of share, however there should be qualifying provision in order to ensure that the squeeze-out can only be utilised when it results in the full control to the offeror.

*ii) Proposal for a special committee of independent directors of a target company to bargain on behalf of shareholders in fundamental transaction squeeze-outs*

One of the purposes of takeover regulations is to ensure the fair treatment of the shareholders of a target company in takeover transactions. The shareholder appraisal remedy also attempts to ensure fairness however cannot be seen as a protection device but rather a right afforded to minority shareholders.

In the South African context many devices are used such as the requirement of the opinion of an independent expert and the majority of the minority approval. The coercive nature of a squeeze-out transaction however may require a further element of a fiduciary duty on the directors owed to the minority shareholders to bargain on

their behalf. It is therefore proposed that the provision be made in the takeover regulations for the appointment of a special committee of independent directors of the target company, during proposed takeover transactions, to act on behalf of shareholders and has the ability to veto proposed transactions.

*iii) Proposal for a supermajority squeeze-out mechanism*

In the tender offer squeeze-out the device can only be utilised by an offeror who has received the threshold acceptances to her offer not including the offeror's holding. Shareholders that do not include the shares held by the eventual acquirer in terms of the transaction must approve a takeover transaction by means of a fundamental transaction.

This leaves a controlling shareholder who already has substantial holding vulnerable to oppression by the minority shareholders. In order squeeze-out the minority shareholders he will either require threshold acceptances to his offer or that the minority vote in favour of a takeover transaction. To allow or remedy such situation it is suggested that a shareholder having reached a certain level of equity holding should be able to squeeze-out the minority shareholders irrespective of how the controller obtained the level of shareholding. These devices are utilised in the jurisdictions as set out in chapter five. There are sufficient modern protection devices to ensure that the affected minority shareholders are treated fairly.

The minority shareholders consisting of insignificant smallholding, should not prohibit the ability for parties to execute substantial commercial transactions, the law must enable this but also ensure that there is fair treatment on the affected minority shareholders.

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