THE PROTECTION OF MINORITY SHAREHOLDERS IN AFFECTED TRANSACTIONS: A COMPARATIVE STUDY

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PREFACE

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CONTENTS

CHAPTER 1
INTRODUCTION

CHAPTER 2
MINORITY SHAREHOLDER PROTECTION AND THE PRINCIPLE OF EQUAL OPPORTUNITY

CHAPTER 3

THE LAW IN THE UNITED STATES

CHAPTER 4

THE LAW IN THE UNITED KINGDOM

CHAPTER 5

THE LAW OF THE EUROPEAN UNION AND THE LAW OF SELECTED MEMBER STATES

CHAPTER 6
AUSTRALIAN LAW

CHAPTER 7
SOUTH AFRICAN LAW

CHAPTER 8
CONCLUSION

8.1 Equal opportunity

8.2 Universal mechanisms for the protection of minority shareholders in takeovers

8.2.1 The mandatory bid

8.2.1.1 Control

8.2.1.2 Persons acting in concert

8.2.1.3 Consideration

8.2.2 The compulsory acquisition procedure

8.2.2.1 Consideration

8.2.2.2 The application to court

8.3 Possible reform of the mandatory bid

8.3.1 Replacing the mandatory bid

8.3.2 Abolishing the mandatory bid

8.3.3 Reforming the mandatory bid

8.4 Conclusion

BIBLIOGRAPHY

ANNEXURE A
STYLE GUIDELINES

CHAPTER 1

INTRODUCTION

1.1 The subject of the study

The Companies Act 61 of 1973 and its Securities Regulation Code on Takeovers and Mergers utilises a number of statutory measures, supplementary to common law remedies, to protect minority shareholders from injustices inflicted by controlling shareholders. The promulgation of the Securities Regulation Code obviated the remedies offered in the Listing Requirements and Rules of the Johannesburg Stock Exchange, rendering the Code of primary importance as it applies to both listed and unlisted public and less closely-held private companies.

Affected transactions, which are colloquially referred to as takeovers, mergers and acquisitions, present a unique regulatory environment. Per definition, the effect of these transactions is that control passes to a new majority shareholder or shareholders, thus necessitating the development of additional measures aimed at the protection of the interests of minority shareholders.

These measures are fundamentally based on a broad principle of equality of opportunity, which is distinctly found in South African law in the provisions relating to the compulsory acquisition of the shares of a company as contained in section 440K and the mandatory bid as contained in Rule 8 of the Securities Regulation Code on Takeovers and Mergers.

These minority shareholder protection measures and the broader principles on which they are based, especially in public companies, form the subject of this study.

1.2 Terminology

Affected transactions, in the context of this study, broadly include takeovers, mergers and acquisitions when such transactions, when effected, have the result that control of the company involved, changes.

The term 'takeover' may be spelt either as it appears here or as 'take-over'. The same variable spelling applies to the plural of the noun.

In the chapter on the law in the United States of America, the terms 'company' and 'corporation' are used interchangeably.

The terms 'offeror' and 'offeree' as will be used in the discussion on all of the jurisdictions studied to denote the acquiring company and acquired company respectively.

The participants in such transactions have, in addition, developed a strong colloquial tradition, which is reflected in the narrative of the text of this study. Where applicable, terms will be explained in the text or explanatory footnotes to the text.

1.3 The importance of minority shareholder protection in affected transactions

The necessity of the protection of minority shareholders is a generally accepted and broadly developed tenet of company law. It is vested with a well-developed core of common law remedies and a number of statutory mechanisms aimed at generic situations. Affected transactions, however, render these shareholders more vulnerable due to the shift in corporate control that characterises it. These situations present a heightened disadvantage for shareholders who may find themselves in a weaker bargaining position or otherwise exposed.

There are a number of important constraints in any review of minority shareholder protection in affected transactions.

1.3.1 The promotion of investor confidence

The importance of investor confidence cannot be underestimated in a developing economy such as South Africa.

The protection of the small investor has been recognised, in a number of the jurisdictions in the scope of this study, as an important factor in the promotion of that investor confidence. In this manner the development of the principles of minority shareholder protection should feature prominently in the South African reform programme.

1.3.2 Globalisation and the competitiveness of the South African markets

The International Monetary Fund has recognised globalisation as a potential source of economic growth and structural change.[1] There is a worldwide trend towards an integration of markets and the process of globalisation is no longer restricted to the industrial countries of the world, but emerging markets, countries in transformation and the developing countries of the world are all being drawn into this process.[2]

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[1] Soontiëns 1998:12.
[2] Stals 1999:1.

Globalisation has been described as the compactation of interactions in a specific area of life, by means of the mutual interpenetration of actors and events across traditional boundaries and the resulting world-wide homogenisation of behaviors, norms and values.[3] It has consequently been identified with the harmonisation of standards, the greatly increased mobility of capital and deregulation, as well as the massive spread of financial markets.[4]

Within a world economy in which the formation of economic unions and regional organisations such as the European Union, the South American Mercosur, the North African OHADA and the Southern African Development Community, which strive to strengthen the economic facets of the international activities of their member states, globalisation and the broad movement towards harmonised standards cannot be neglected. It is of vital importance to South African markets that the regulatory systems applicable to it are of a standard and content comparable to its major global competitors.

1.3.3 Empowerment objectives and the South African economy

South Africa is currently engaged in an extended process of redress at all levels of its society. This process aims to correct the imbalances created by its former system of governance and involves, not only the social, but also the economic empowerment of previously disadvantaged groups.

This broad aim is reflected in the aims of the majority of new legislation promulgated. As a consequence, the importance of the uniquely South African social context may not be neglected in any attempts at the reform of market regulation.

1.4 The aims of the study

This study of the protection of minority shareholders in affected transaction is threefold in aim.

Firstly, the study is undertaken to evaluate minority shareholder remedies not specific to the context of affected transactions in that context. These remedies, as they have developed in South Africa, will form the subject of a focussed study. Comparable remedies in the other jurisdictions included in this study will be evaluated more cursorily and juxtapositioned against the South African remedies examined.

Secondly, the context-specific minority shareholder remedies will be examined against the background of both the price- and opportunity facets of the principle of equal opportunity in the sale of shares. These remedies will be studied employing comparative methodology and

[3] Pakote 1997:1.
[4] Biersteker 1998:15.

with due recognition of the difference in each jurisdiction's market structure, circumstances and legal tradition.

Thirdly, some broad conclusions on the efficacy and desirability of these remedies, based on the evolution of these remedies, will be drawn.

1.5 The scope of the study

This study comprises a comparison of the remedies available to minority shareholders in a variety of jurisdictions in circumstances where control of the company in which they are shareholders, changes with possible detrimental consequences.

This study is limited to the provisions contained in the companies legislation and securities regulation codes of the jurisdictions studied. In the exposition of South African law, listing requirements and stock exchange rules are not included in the study due to the fact that the promulgation of the Securities Regulation Code in 1990 obviated the necessity for the inclusion of such remedies in those codes. Comparable rules in other jurisdictions are consequently not studied. Reference to judicial precedents is included, especially where such precedents serve to elucidate the provisions contained in legislation.

1.6 Exposition of the study: structure and choice of jurisdictions

At the outset, minority shareholder protection mechanisms and the remedies available to aggrieved minority shareholders are briefly discussed in order to place the remedies indigenous to affected transactions in its broader context. The development of some of these remedies are discussed to highlight the importance of the founding tenets to the notion of the principle of equal opportunity. Particular attention is paid to the fiduciary duty to account as it is found in the law of partnership to emphasise the reflection of partnership principles in the mechanisms aimed at the protection of minority shareholders in affected transactions.

Selected aspects of the law in the United States are studied in order to present a balanced view of the alternative mechanisms of minority shareholders protection. In addition, a number of judgments and academic articles on the notion of equality of opportunity in the sale of shares are examined in order to determine the impact of these principles and arguments on American law. Possible parallels with the law in other jurisdictions are examined.

The unique importance of company law in the United Kingdom to the development of South African company law, coupled with the similarity between the South African Securities Regulation Code on Takeovers and Mergers and the London City Code, necessitates a study of UK law studied independently of the European Union law within which it functions. This

approach is aimed at bringing to light the development of the notion of equal opportunity contained in the City Code on which the South African code is based.

European Union law, and most notably the Draft Thirteenth Directive, is studied in order to highlight the conflicting considerations inherent in, especially, the mandatory bid and the provision of statutory protection to minority shareholders. The takeover codes and legislation of three member states are then examined in order to evaluate the most recent measures. Key aspects of the codes and acts are examined in order to highlight the variant interpretation of the notions of control and equality.

Australia has recently completed an extensive Corporate Law and Economic Reform Programme in which effectively implementing the principle of equal opportunity played an important role. The mandatory bid was especially contentious and an exposition of this process is included in this study to highlight the rationale and the growing importance of minority shareholder protection in developed economies.

Against this background the provisions applicable to the regulation of takeovers and mergers in South Africa are examined in order to expose the particular regulatory environment applicable to affected transactions. Both manifestations of the principle of equal opportunity, the compulsory acquisition procedure and the mandatory bid are subsequently examined with reference to applicable case law and compared in their applicability and efficacy.

In conclusion, the desirability of maintaining, developing or rejecting these principles and mechanisms in the particular South African environment is evaluated.

1.7 Reference style

The reference style of the Journal for Juridical Science as published by the Faculty of Law of the University of the Orange Free State is followed. See Annexure A.

CHAPTER 2

MINORITY SHAREHOLDER PROTECTION AND THE PRINCIPLE OF EQUAL OPPORTUNITY

2.1 Introduction

Though the focus of this study is the protection of minority shareholders by means of the equal opportunity principle within the specific arena of takeovers, it is necessary to review the general principles applicable to the protection of minority shareholders in South African company law. In addition, it is necessary to survey the regulation of take-overs and mergers in competition law to explore some of the possible remedies available to minority shareholders in the applicable legislation.

The principle of equal opportunity and its role in the protection of minority shareholders, will be examined cursorily to place the remainder of the discussion on the possible origins of the rule in analogous figures of the law of partnership, in context.

In conclusion the efficacy of these remedies will be discussed. This exploration will form the basis for the discussion of the broad spectrum of remedies to be found in the jurisdictions that form the subject of this study. In addition, it forms a necessary foundation for some of the ultimate conclusions in this study.

2.2 Minority shareholder protection

In the 1969 judgment in *Sammel and Others v President Brand Gold Mining Co Ltd* [1] Trollip JA made the following comment on the position of the typical shareholder:-

> '[B]y becoming a shareholder in a company, a person undertakes by his contract to be bound by the decisions of the prescribed majority of shareholders, if those decisions on the affairs of the company are arrived at in accordance with the law, even where they adversely affect his own rights as a shareholder.'[2]

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[1] 1969 (3) SA 629 (A).
[2] See also the discussion by Blackman 1995:par 190 on majority rule.

The shareholder's primary power to influence the policy or activities of a company of which he/she is a member, is the right to vote at a general meeting.[3] In some introductory texts on company law, some authors even state:

> 'it has long been accepted that a shareholder may cast his vote in any way he pleases, and may act as capriciously as he desires, for he owes no fiduciary duties either to the company or to the other shareholders.'[4]

Whatever the nature of obligations incumbent on the shareholder may be, a shareholder may sometimes find him/herself in the minority when a resolution is passed at a meeting.[5] In addition, the directors, who may be vested with the primary responsibility for the management of the day-to-day affairs of the company, can be elected in general meeting by means of a majority vote.[6] The obvious result is that the minority shareholders in any company are susceptible to a singular impotence that may result in relation to the management of the affairs of the company. In itself, this is no cause for action, as the minority ascribes to this state of affairs upon the purchase of their shares. It is only once the majority abuses the authority gained by sheer numbers, that the interests of the shareholders in the minority are protected through a variety of mechanisms.[7]

One of the primary functions of company law is the effective demarcation of the balance of interests between majority shareholders, minority shareholders and the directors of a company.[8]

The protection of minority shareholders is emerging as one of the primary trends in international corporate governance. It has, in fact, even been argued that for some time yet, ensuring the protection of minority shareholders should remain a higher priority than enhancing managerial accountability.[9]

Minority protection does not constitute the mere creation of remedies. Ideally it encompasses a process aimed at balancing, on the one hand, the relationship between the members and the management of the company, and, on the other hand, the relation of power between the

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[3] Oosthuizen 1981:105.
[4] Beuthin & Luiz 1991:169. This view is to some extent supported by Blackman 1995:par 190 relying on *Pender v Lushington* (1877) 6 ChD 70, *North-West Transportation Co Ltd 7 Beatty v Beatty* (1887) 12 App Cas 589 (PC), *Burland v Earle* 1902 AC 83 (PC), *Gundelfinger v African Textile Manufacturers Ltd* 1939 AD 314. See, however, the judgment in *Clemens v Clemens Bros Ltd and another* [1976] 2 All ER 268:282.
[5] Oosthuizen 1981:105.
[6] Blackman 1995:par 188. See also Gibson 1997:379.
[7] Golberg 1994:2.
[8] Ooshuizen 1981:105.
[9] Cheffins 2000:41.

members *inter partes*.[10] The Van Wyk de Vries Commission indeed pointed out that the mere text of the Companies Act can never suffice to afford adequate protection to minority shareholders: this task could only be accomplished by merging the large number of measures in the Act and weighing the interests of the shareholders of the company in relation to each.[11]

There are four broad categories of methods that may be employed to bring rogue directors to book:-

a) shareholders may exercise their voting powers to control the management of the company in which they chose to invest, but may be hampered in exercising such control effectively in instances where they find themselves in the minority;

b) criminal proceedings may be instituted, but through the limited resources of criminal enforcement agencies and the severe burden of proof, such remedies are rarely used;[12]

c) administrative controls are imposed in certain instances, but are limited in their scope and applicability;[13] and

d) legal action may be brought by shareholders.[14]

Though such legal action cannot be limited so as to render it the exclusive refuge of minority shareholders, this study is primarily concerned with situations where the complainant is indeed in the minority. A sound review of the basic principles indigenous to minority shareholder protection, is necessary to place the particular principles applicable in takeovers and mergers into proper perspective.

2.2.1 The rule in *Foss v Harbottle*

The rule in *Foss v Harbottle*[15] is, in essence, based on the principles set out above. It encompasses the following:-

a) if a wrong is committed against the company, the company must take action in rectification;[16]

b) if the company fails to do so, a member may institute such action on behalf of the company; but

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[10] Hurter 1996:11.
[11] Republic of South Africa 1970:63.
[12] Henning 1995:47 – 53.
[13] Blackman 1979:239. The Minister for Economic Affairs (now the Minister for Trade and Industry) is afforded a measure of administrative control and, more specific to the context of this study, the Securities Regulation Panel on Takeovers and Mergers is afforded administrative enforcement jurisdiction in a number of matters.
[14] Schreiner 1979:206 – 209.
[15] (1843) 2 Hare 461, 67 ER 189.
[16] This provision has been termed the 'proper plaintiff' rule. Doyle 1992:1172. See also Cilliers et al 1992:288.

c) the company may, in certain circumstances condone the wrong by a simple majority decision, in which circumstances the member is no longer entitled to institute such action.[17]

So, for instance, where a shareholder complains of a diminution in share value resulting from a wrong committed by the company, such damages cannot be claimed from the wrongdoer if the company has a claim against the wrongdoer for the loss suffered.[18] Allowing such an action would result in a doubled recovery of the loss, which is unacceptable in South African law.[19]

This rule does not constitute minority protection – it rather confirms majority rule.[20] In fact, the rule has been described as an epitome of the failure of the common law to provide for the protection of minority shareholders in 'anything like an adequate way.'[21]

Conversely, the rule in *Foss v Harbottle* has been described as the guardian of two key principles of company law: the rule secures the principles of majority rule through denying the court jurisdiction to interfere in the internal management of the company and it safeguards the corporation principle by insisting that the company alone may enforce its rights.[22]

It is submitted that, in order to support certainty in corporate management, the latter two principles of company law have intrinsic practical value. A corporate management exposed to the uncertainty inherent in a potentially litigious environment can, of necessity, not function as effectively as would otherwise be the case. In addition, it is necessary to safeguard the separate existence of the corporate entity.

The minority shareholder remedies that have been developed in South African company law make sufficient provision for the protection of minority shareholders so that these tenets need not be altered.

2.2.2 Personal action

[17] See also the discussion by Van der Merwe 1993:216 – 218.
[18] Blackman 1995: par 192.
[19] *Golf Estates (Pty) Ltd v Malherbe* 1997 (1) SA 873 (C); Pretorius 1999:397.
[20] Cilliers et al 1992:290. See also Van der Merwe 1993:218.
[21] Doyle 1992:1172.
[22] Blackman 1976:27.

Should the conduct of the majority of shareholders in a company exceed permissible limits, a member of the company may institute a personal action against the company.[23] Such a situation could arise in a threefold of circumstances.

In instances where the member's rights in terms of the memorandum or articles, such as the right to vote at a general meeting, the right to hold the company to actions within the scope of the objects of the company and his/her right to insist on the observance of the articles of the company in regard to his/her rights as member are infringed upon, such a member would have recourse employing the personal action.[24]

In addition, such action may be brought where an infringement of membership rights is brought about by illegal conduct or conduct in contravention of the common law. Failure to obtain a majority prescribed in the act, where that majority is required as a measure for the protection of minority shareholders or the illegal reduction of capital, such as the payment of dividends out of capital would constitute such conduct.

It is also possible to employ the personal action pursuant to the commission of 'fraud on the minority'. In that context, the term fraud[25] relates to an abuse of power analogous to the misuse of a fiduciary position and the term 'minority' is not limited in application to the minority shareholders, but may refer to a wrong done to the company.[26]

One of the most important applications of the personal action relates to the enforcement of the rights of a member in terms of the company constitution.[27] The relationship between the members of a company is essentially contractual in nature[28] and the enforcement of those rights may be of significant importance to the protection of shareholder's rights.

Despite the potential of this remedy, the courts have been hesitant in its enforcement of members' constitutional rights due to the fact that a member's *locus standi* to bring action is determined with reference to the power of majority shareholders to ratify these wrongs. Moreover, sceptical authors have argued that this hesitancy is the result of a fear of a rush of shareholder actions.[29]

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[23] Van der Merwe classifies these rights as 'indiwiduele regte' (individual rights)and avers that the term usuallu refers to membership rights.
[24] Blackman 1995: par 195; Van Rooyen 1986:196.
[25] In United Kingdom jurisprudence the term 'fraud' in this context has been held to include appropriation of the company property, wrongdoer control of the company and abuse of power, whether unintentional, intentional, negligent, or fraudulent. See in general Doyle 1992:1172.
[26] Cilliers et al 1992:294.
[27] Van Rooyen 1986:196.
[28] Cilliers et al 2000:111.
[29] Van Rooyen 1986:215.

2.2.3 Derivative action

Where the personal action is based on an infringement of the rights of the shareholder, the employment of the derivative action is reliant upon a wrong to the company. In instances where the company cannot, or will not, act to correct that wrong itself, due to the fact that the wrongdoers are in control of the company,[30] members may institute action on behalf of the company. Such an action is instituted by members of the wronged company against the wrongdoers on behalf of all the shareholders other than the wrongdoers.[31]

The derivative action may be instituted firstly, where an unratifiable wrong has been done to the company. The following classification of such wrongs may be followed:[32]

a) acts in breach of the rights of the company, including ultra vires acts, acts beyond the authority of the agents of the company and the payment of dividends in contravention of the memorandum.[33]

b) unlawful conduct and conduct in breach of the common law, which amounts to a wrong to the company, such as theft of company funds, or a contravention of section 38[34] of the Companies Act.[35]

c) fraud on the minority, where such action constitutes an unratifiable wrong in that the wrongdoer acts in bad faith towards the company in his/her capacity as director or that the ratification will have the effect of enriching the wrongdoer at the expense of the company.[36]

It may well be noted that the derivative action cannot be used in circumstances where the wrong to the company results from mere negligence.[37] The Van Wyk de Vries Commission thought it unwise to extend the action or to develop it further and directed that suitable aid be sought elsewhere.[38]

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[30] Cilliers et al 1992:297. See also van der Merwe 1993:219.
[31] Blackman 1995: par 205. See also Gibson 1997:382; Cilliers et al 1992:295.
[32] Beuthin and Luiz 1991:170 – 171 offer a different classification with similar substance:
a) when the relevant act is an illegal act;
b) the act is *ultra vires* the company;
c) an act that may be validly effected by means of a special resolution has been attempted by means of a simple majority;
d) the majority are committing 'fraud on the minority';
e) a meeting cannot be called in time to have any practical effect; or
f) an individual member claims that his/her rights have been infringed.
[33] Blackman 1995: par 195.
[34] Section 38 makes provision for the prohibition of financial assistance to purchase the shares of a company or holding company in certain circumstances.
[35] Companies Act 61 of 1973.
[36] Blackman 1995: par 194.
[37] Gibson 1997:382.
[38] Republic of South Africa 1970:76.

The action is, in fact, so limited in its scope and application in this regard, that it is regarded as a remedy that means little as a measure directed at the protection of minority shareholders.[39] It is, for instance, within the power of the majority to effectively ratify certain breaches of directors' duties, denying a member the right to enforce those duties. In addition, considerable uncertainty exists as to the kind of rights enforceable by members through the employment of this action and the form of the common law derivative action is both complex and cumbersome.[40]

These factors are aggravated by the fact that minority shareholders rarely have access to the information necessary to found an action[41] and the shareholder bringing the action faces a significant risk of ultimately bearing the costs of an unsuccessful application.[42]

Instead of extending this action, the legislature enacted section 266, 267 and 268 of the Companies Act[43] to introduce an extended and more flexible statutory derivative action, aimed at more effective enforcement of the rights of minority shareholders in the company.

2.2.4 Statutory derivative action

2.2.4.1 Historical background

In the 1926 South African Companies Act[44] provision was made for a type of statutory derivative action in section 95*sext*(3) enabling the Minister to institute action for the recovery of damages in respect of any fraud, delict or other misconduct, if it was considered in the public interest to do so. In addition, a personal action was provided for in section 111*bis*, which allowed the court to make appropriate orders on the application of a member claiming oppressive conduct.[45] This section was closely modelled on section 210 of the act[46] in the United Kingdom.[47]

The Van Wyk de Vries Commission was of the opinion that both of these remedies available to minority shareholders were of limited value.[48] The Commission was, to an extent, in

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[39] Republic of South Africa 1970:67.
[40] Blackman 1976:28.
[41] It may, however, well be argued that the newly-promulgated Promotion of Access to Information Act 2 of 2000 can significantly improve the position of shareholders.
[42] Oosthuizen 1985:325.
[43] Companies Act 61 of 1973.
[44] Companies Act 46 of 1926.
[45] Gibson 1997:383.
[46] Companies Act 1948.
[47] Oosthuizen 1981:107.
[48] Blackman 1995: par 210 at fn 2. See also Gibson 1997:383.

agreement with the recommendations made by the Jenkins Commission[49] in the United Kingdom, upon whose efforts section 75 was inserted in the 1980 United Kingdom Companies Act.[50]

In the place of sections 95*sext*(3) and 111*bis*, the Commission decided to break new ground with the combination of the principles of inspection with a derivative action in terms of which a member could initiate proceedings on behalf of the company.[51]

This step has been hailed by some as a significant inroad upon majority rule in that it prohibits ratification barring an action brought by one of the members of the company. The court is empowered to set aside any such ratification of a director's breach of fiduciary duties allowing an action to proceed and, as a consequence, overruling majority rule.[52]

2.2.4.2 Grounds for bringing the statutory derivative action

The statutory derivative action is provided for in section 266(1) of the Companies Act[53] and enables a member to approach the court for the appointment of a *curator ad litem* to institute proceedings on behalf of the company. This curator has the same powers as an inspector appointed by the Minister, a mechanism that facilitates the gathering of the information necessary to bring the action.[54]

A member of the company[55] may institute the statutory derivative action in circumstances where the following pre-requisites have been met:

a) the company must have suffered loss or damages or been deprived of any benefit as a result of a wrong against the company, breach of faith or breach of trust;

b) the company may not have instituted any proceedings aimed at the correction of the wrong; and

c) the wrong, breach of trust or breach of faith, must have been committed by any director or official of the company, or any past director or official of the company while in office.[56]

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[49] Report of the Company Law Committee 1962.
[50] Oosthuizen 1981:107 – 108.
[51] Republic of South Africa 1970:68; Gibson 1997:388.
[52] Blackman 1976:29.
[53] Companies Act 61 of 1973.
[54] Schreiner 1979:240 – 241.
[55] *Brown v Nanco (Pty) Ltd* 1977 (3) SA 761 (W); Oosthuizen 1985:323; Schreiner 1979:241. The action may only be instituted by a member of the company formally so noted in the register of the company.
[56] See for instance the case of *Brown and others v Nanco (Pty) Ltd* 1976 (3) SA 832 (W) where it was averred by the applicants that the directors of the company were receiving remuneration to which they were not entitled. See also Meskin 1994:511.

This remedy was introduced in facilitation of the process whereby an individual shareholder may institute proceedings on behalf of the company.[57] It has been described as an action for the use of those minority shareholders that are at the disadvantage of having no access to the company's records.[58]

2.2.4.3 Relief

On such application[59] the court may appoint a provisional *curator ad litem* who will conduct an investigation relating to the possible grounds for proceedings, the desirability of such proceedings and the institution of such proceeding.[60]

It has been held that the scope of the investigation to be conducted is limited to the *prima facie* grounds put forward by the applicants and that the *curator ad litem* was not required to conduct a general investigation into the affairs of the company.[61] The term 'desirability' as it relates to the envisaged proceeding is, however, unqualified and it has been submitted that the term relates to the interests of the company as a business.[62]

On the return day of the order, the appointed provisional curator must report to the court on these issues. Such an appointment will only be granted if the court has availed itself of the available information and found that the company has not itself instituted proceedings,[63] that there are prima facie grounds for bringing an action[64] and that the bringing of such and action is justified.[65]

On the return day, the court may then take action in one of the following manners:-

a) discharge the provisional order;[66] or

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[57] Cilliers et al 1992:299.
[58] *Van Zyl v Loucol (Pty) Ltd* 1985 (2) SA 680 (NC):685.
[59] Blackman 1994:512. The applicant need only establish a *prima facie* case and not the reasonable success of proceedings, should they ultimately be instituted.
[60] Blackman 1994:512. The investigator is not entitled to make a general investigation of the affairs of the company: it is merely an enquiry to assist an aggrieved shareholder by means which complement his/her common law rights.
[61] *Loeve v Loeve Building and Civil Engineering Contractors (Pty) Ltd* 1987 (2) SA 92 (D). See also the judgment in *Thurgood v Dirk Kruger Traders (Pty) Ltd* 1990 (2) SA 44 (E) in which it was held that the curator did have a discretion as to the proceedings or relief to be pursued.
[62] Blackman 1976:29.
[63] Companies Act 61 of 1973:s 266(3)(a). This requirement refers to the company's failure to institute proceedings within one month after receiving a written request from the member bringing the action to do so.
[64] Oosthuizen 1985:326. Such prima facie grounds may exist in damages suffered by the company or an advantage the company has been deprived of as a result of unlawful action, or breach of fiduciary duty by a director.
[65] Gibson 1997:389.
[66] Blackman 1994:513. The court will discharge the provisional order if no substantial grounds exist for bringing such proceedings. In addition the fact that the applicant may have ceased to

b) confirm the *curator ad litem*'s appointment; and

c) issue directions to the curator for the institution and execution of proceedings as it may think necessary; and

d) order that any resolution in ratification or condonation of the applicable wrong shall be void.[67]

The action may only be brought after notice of it has been served on the company: it is in fact required prior to the granting of the provisional order.[68] Such a notice need not detail the amount of damages allegedly caused or the precise circumstances in which the loss came about. It should, however be sufficiently detailed to enable the company to know what proceedings it is being called on to institute.

This procedure provides in a number of needs pertinent to the protection of minority shareholders. Adequate provision is made for circumstances where crimes are committed by directors and prosecution is required. Adequate provision is also made for the recovery of damages by the company and ultimately by the shareholders, instances where directors commit a wrong against the company, as a result of which the company suffers damages.

In addition, these measures make better provision for the provision of relevant information on the affairs of the company to shareholders and better protection is afforded to these shareholders in instances where minority shareholders are unfairly treated but the treatment is not detrimental to the company itself.[69]

2.2.5 Appointment of inspectors

The Minister is also afforded the discretion to appoint inspectors to investigate the affairs of a company. Such a discretion arises under the following circumstances:-

a) when 100 members of the company in question, holding at least 5% of the issued shares make an application for the appointment of such an inspector.[70]

b) where there are circumstances suggesting:-

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be a member of the company by the return date will be relevant to the courts decision and the order may well be discharged if the remaining members of the company were opposed to the institution of such proceedings. See also the judgment in *Loeve v Loeve Buidling and Civil Engineering Contractors (Pty) Ltd and others* 1987 (2) SA 92 (D).

[67] Companies Act 61 of 1973:s 266(4). See also the discussion by Meskin 1994:512 – 514.

[68] Blackman 1994:511.

[69] Republic of South Africa 1970:68 - 69.

[70] Blackman 1994:477. The alternative to an application brought under this section is an application that the company because wound up on the ground that it is just and equitable for the court to do so.

i) that the company was either formed for fraudulent or unlawful purposes, or was being managed for those purposes, or in a manner oppressive to its members;

ii) that the founders or managers of the company acted fraudulently towards the company or its members; or

iii) that information that the members may reasonable expect to have, has been withheld.[71]

The converse of this discretion to appoint an inspector is that the Minister may refuse to appoint an inspector and it has been submitted that he/she will only do so upon suspicion of serious mismanagement and the withholding of information from the members of the company.[72]

This discretion in turn, reverts to an obligation to make such an appointment in circumstances where[73] the company adopts a special resolution that its affairs should be investigated or where the court orders that the affairs of a company be so investigated.[74]

A number of guidelines in this regard were laid down by the court in the judgment delivered in *Sage Holdings Ltd v The Unisec Group*[75] by Goldstone J: The court has a wide discretion to order an investigation when it deems it right or advisable to do so and in deciding this, the court will have regard to the matters set out in section 258(2). Such grounds should be clear and undisputed, save in instances where the dispute itself would justify an investigation and in instances where the court takes steps on a mere suspicion of grave impropriety, such a suspicion should be well founded and have a substantial base. It was held that the court should act only if it is satisfied that an object, such as the recovery of damages or winding-up of the company, will ultimately be achieved and not merely to satisfy some disgruntled shareholders. Recognition was given to the fact that the provision provides a useful tool for the court to grant relief in instances where the management of a company has put itself beyond the reach of a shareholder, but also that courts could differentiate between large public companies and small non-trading companies due to the potential harm and damage that may be done to a company.

The advantages of this provision under this section, were envisaged as dual in nature. Firstly, the shareholder will ultimately be in possession of more information regarding the affairs of

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[71] Companies Act 61 of 1973:s 257.
[72] Gibson 1997:384.
[73] Companies Act 61 of 1973:s 258.
[74] Cilliers et al 1992:304.
[75] 1982 (1) SA 337 (W).

the company and secondly the section provides a procedural advantage with relation to the aid afforded by it.[76]

Though this section was designed to empower minority shareholders to make such an application to the Minister at the cost of as little as R 200.00, attendant costs 'rears its head in the strangest places.'[77] The aggrieved members may well become ultimately responsible for funding the expenses of the professional investigators thus appointed by the Minister.[78]

2.2.6 Relief from oppression

The statutory derivative action may be traced from the 1945 Cohen Committee report[79] and the ensuing enactment of section 210 in the 1845 United Kingdom Companies Act.[80] Both the Jenkins Commission in the United Kingdom[81] and the Van Wyk de Vries Commission in South Africa[82] recognised the ineffectual functioning of oppression remedies and, as a consequence, section 75 was enacted into the British Companies Act[83] and section 252 into the South African Companies Act.[84]

Section 252 of the Companies Act[85] provides an additional remedy to oppressed minority shareholders.[86] In fact, this remedy constitutes one of the only remedies not derived from the company's obligation to institute proceedings on its own behalf.[87] This action may be brought when any member[88] of a company complains that an act of the company is unjust, unfairly prejudicial or inequitable, or that the affairs of the company are being conducted in the manner described above.[89]

Though the Van Wyk de Vries Commission recognised that the words 'unfairly prejudicial, unjust or inequitable' were difficult to define precisely, it was considered easier to interpret

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[76] Republic of South Africa 1970:65.
[77] Golberg 1994:5.
[78] Companies Act 61 of 1973: s 263.
[79] The Committee on Company Law Amendment.
[80] Oosthuizen 1981:106 – 107.
[81] Report of the Company Law Committee 1962.
[82] Die Kommissie van ondersoek na die Maatskappywet 1970, hereafter the Van Wyk de Vries Commission of Inquiry into the Companies Act..
[83] Companies Act 1980.
[84] Oosthuizen 1981:108.
[85] Companies Act 61 of 1973.
[86] Van Rooyen 1986:217; Oosthuizen 1981:109; The action is only available to persons who are formally registered as members of the company or signatories to the memorandum of incorporation of the company. The executor, administrator, curator or guardian of the estate of such a shareholder is included in the register of the company as a shareholder *nomine oficii.*
[87] Blackman 1995: par 217. See also Gibson 1997:390.
[88] *Lourenco and others v Ferela (Pty) Ltd and others* (No 1) 1998 (3) SA 281 (T).
[89] Gibson 1997:390.

than the term 'oppressive', which it replaced. The practical result is that the burden of proof on the applicant for relief is less onerous.[90] The following guidelines have been laid down as to the interpretation and application of these requirements:-[91]

a) the word 'unfairly' qualifies only the term 'prejudicial', and not the terms 'unjust' or 'inequitable';[92]

b) the applicant should prove both that the conduct on which the action is founded is so prejudicial, unjust or inequitable and that it is just and equitable that the court should make an order in terms of this section;[93]

c) the construction of the words should add to the remedy provided to minority shareholders rather than limit its application; and

d) the ambit of the remedy under section 252[94] is more extensive than that of its predecessor.[95]

Consequently it has been submitted that the court will intervene in circumstances where the majority shareholders are using their greater voting power unfairly to prejudice or acting in a manner which does not allow minority shareholders to enjoy a fair participation in the affairs of the company. In addition, the court will intervene where their conduct reveals a lack of probity or fair dealing, or a visible departure from the standards of fair dealing which ultimately amounts to unfair discrimination against the minority.[96]

It is essential that the applicant set out the relief sought.[97] The court may then make any order it sees fit in the relevant circumstances and is not limited to the relief sought by the applicant in giving this order.[98] In addition, the prejudice need not accumulate to the applicant. It is sufficient to prove prejudice to any member as member.[99]

The oppressive conduct has to be that of the company, but in most instances majority shareholder conduct suffices as company conduct. Such action can also be performed by directors, the chief executive officer or any other person or persons in *de facto* control of the company.[100]

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[90] Meskin 1994:478.
[91] *Donaldson Investments (Pty) Ltd & others v Anglo-Transvaal Collieries Ltd: SA Mutual Life Assurance Society & another intervening* 1979 (3) SA 713 (T):719 – 720.
[92] Meskin 1994:478.
[93] Meskin 1994:477. It has also been put forward that the applicant should establish the nature of the relief sought. See, for instance, the judgment in *Lourenco and others v Ferela (Pty) Ltd and others* (No 1) 1998 (3) SA 281 (T).
[94] Companies Act 61 of 1973.
[95] Companies Act 46 of 1926:s 111*bis*.
[96] Meskin 1994:479.
[97] Meskin 1994:477.
[98] Meskin 1994:477. See also the judgment in *Heckmair v Beton & Sandstein Industrieë (Pty) Ltd en Andere* (1) 1980 (1) SA 350 (SWA).
[99] Van Rooyen 1988:270; Oosthuizen 1981:112.
[100] Oosthuizen 1981:118.

Applications under this section are, however, not common and have indeed been termed 'as scarce as snow in summer.'[101] Two reasons have been put forward in justification for this situation, namely the cost of bringing such an application and the onerous burden of proof on the minority shareholders.[102]

Such shareholders are required not only to prove that the action was unjust, unfairly prejudicial or inequitable, but also that it is just and equitable that the court order relief. In addition, the action is not available for anticipated wrongful conduct and grants the minority shareholders no advance protection.[103]

2.2.7 Conclusion

Though a significant number of remedies are provided for at both common and statutory law, it is necessary to make a finding as to the practical effectiveness of these remedies. The real necessity may be weighing the legal costs involved in bringing such action against the company, or the majority shareholders, against the benefit and the minority shareholders capacity to do so. In fact, it has been said that:-

> 'it is fair to say that, while our law subscribes to the philosophy that an aggrieved party has the right to be heard in court, the pragmatics of the situation makes this philosophy as extinct as the dinosaur.'[104]

It is submitted that a right of action may, in itself, not afford the aggrieved minority shareholder the protection necessary. It is necessary to study some alternative mechanisms through which the shareholder may not be personally avenged, but which bears a measure of relief in qualified circumstances.

2.3 The regulation of competition: shareholder protection in takeovers and mergers?

The stated purpose of the Competition Act is to provide for the establishment of a Competition Commission responsible for the investigation, control and evaluation of restrictive practices,

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[101] Golberg 1994:5.
[102] Golberg 1994:5.
[103] Van Rooyen 1986:218. See also the judgments in *Porteus v Kelly and others* 1975 (1) SA 219 (W) and *Investors Mutual Funds Ltd and Another v Empisal (South Africa) Ltd and others* 1979 (3) SA 170 (W).
[104] Golberg 1994:3.

abuse of dominant position, and mergers. It also makes provision for the establishment of a Competition Tribunal responsible for the adjudication of such matters and for the establishment of a Competition Appeal Court.

The act was promulgated in recognition of such uniquely South African economic and social realities as:-

a) that apartheid and other discriminatory laws and practices of the past resulted in excessive concentrations of ownership and control within the national economy, weak enforcement of anti-competitive trade practices, and unjust restrictions on full and free participation in the economy by all South Africans;

b) that the economy must be open to greater ownership by a greater number of South Africans; and

c) that an efficient, competitive economic environment, balancing the interests of workers, owners and consumers and focused on development, will benefit all South Africans

and aims, *inter alia*, at the provision of an equal opportunity to all South Africans to participate fairly in the national economy, achieving a more effective and efficient economy in South Africa, creating greater capability and an environment for South Africans to compete effectively in international markets and regulating the transfer of economic ownership in keeping with the public interest.[105]

Against this background, it is necessary to study the manner in which the Competition Act regulates takeovers and mergers in South Africa.

2.3.1 The Competition Act and the regulation of mergers

While the act focuses on the regulation of competition law, explicit provision is made for mergers.[106] Within the context of this regulatory sphere, a merger is defined as the direct or indirect establishment of control in the business of a competitor, supplier, customer or other person, whether that control is achieved as a result of purchase or lease of the shares, interest, or assets of that business, amalgamation or combination with that business or any other means.'[107]

One of the variant factors in the protection of minority shareholders that will be focused on in each jurisdiction that forms the focus of this study, is the notion of a shift in corporate control

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[105] Competition Act 89 of 1998:Preamble.
[106] See chapter 3 of the Competition Act 89 of 1998 headed 'Merger Control'.
[107] Competition Act 89 of 1998:s 12(1).

and the exact meaning that may be attached to control. Control is, in turn defined in the following terms:

> 'A person controls a firm if that person-
>
> (a) beneficially owns more than one half of the issued share capital of the firm;
>
> (b) is entitled to vote a majority of the votes that may be cast at a general meeting of the firm, or has the ability to control the voting of a majority of those votes, either directly or through a controlled entity of that person;
>
> (c) is able to appoint or to veto the appointment of a majority of the directors of the firm;
>
> (d) is a holding company, and the firm is a subsidiary of that company as contemplated in section 1 (3) (a) of the Companies Act, 1973 (Act No. 61 of 1973);
>
> (e) in the case of firm, that is a trust, has the ability to control the majority of the votes of the trustees, to appoint the majority of the trustees, to appoint or change the majority of the beneficiaries of the trust;
>
> (f) in the case of a close corporation, owns the majority of the members' interest, or controls directly, or has the right to control the majority of members' votes in the close corporation; or
>
> (g) has the ability to materially influence the policy of the firm in a manner comparable to a person who, in ordinary commercial practice, can exercise an element of control referred to in paragraphs (a) to (f).'

In conformity with these provisions, a threshold is set on two levels for the applications of the provisions of this chapter of the Competition Act. A distinction is drawn between 'intermediate'[108] and 'large'[109] mergers with reference to the thresholds set by the Minister in terms of the combined annual turnover or assets of the companies involved, either in general or in relation to specific industries.[110]

Any party to a merger subject to the provisions of this act, must notify the Competition Commission of that merger within seven days after the conclusion of the merger agreement,

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[108] Competition Act 89 of 1998:s 11(3)(a).
[109] Competition Act 89 of 1998:s 11(3)(b).
[110] Competition Act 89 of 1998:s 11(1)(a).

the public announcement of a proposed merger bid or the acquisition by any one of the parties to that merger, of a controlling interest in another, whichever occurs earliest.[111]

The parties to the merger are subsequently restrained from implementing that merger until they have received approval from the Competition Commission, the Competition Tribunal or the Competition Appeal Court. The Competition Commission is empowered to approve the merger, approve the merger subject to any conditions or to prohibit the merger.[112] In the case of an intermediary merger the Competition Commission has an absolute discretion in this regard, but where large mergers are concerned, both the Commission and the Minister are endowed with the powers described above.

If the Competition Commission approves a merger subject to any conditions or prohibits a merger, any party to the merger may request the Competition Tribunal to consider the conditions or prohibition. The Tribunal may then approve the merger, approve the merger upon the conditions set, or prohibit the implementation of the merger.[113]

Whenever required to consider a merger, the Competition Commission or Tribunal must initially determine whether or not the merger is likely to substantially prevent or lessen competition, by assessing a number of factors indicative of possible future competition.[114] If it appears that the merger is likely to substantially prevent or lessen competition, the Commission or the Tribunal must then determine-

a) whether the merger is likely to result in any pro-competitive gain which will offset the effects of any prevention or lessening of competition, that may result or is likely to result from the merger, and would not likely be obtained if the merger is prevented; and

b) whether the merger can or cannot be justified on substantial public interest grounds such as the effect that the merger will have on a particular industrial sector or region, employment, the ability of small businesses, or firms controlled or owned by historically disadvantaged persons, to become competitive and the ability of national industries to compete in international markets.[115]

A right of appeal is provided[116] and the Minister is empowered to participate in proceedings in order to make representations on any public interest ground referred to above.[117]

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[111] Competition Act 89 of 1998:s 13(1).
[112] Competition Act 89 of 1998:s 14(1)(b).
[113] Competition Act 89 of 1998:s 15.
[114] See the factors set out in section 16(2) of the Competition Act 89 of 1998.
[115] Competition Act 89 of 1998:s 16(3).
[116] Competition Act 89 of 1998:s 17.
[117] Competition Act 89 of 1998:s 18.

2.3.2 A possible remedy for dissenting shareholders?

A complaint against a prohibited practice in terms of the Competition Act may be initiated either by the Commissioner, or by any other person by submission to the Competition Commission.[118]

Upon receiving such a complaint, the Commissioner must instruct an inspector to investigate the complaint as quickly as possible.[119] The Commissioner is afforded wide powers in this regard. Any person questioned by an inspector conducting such an investigation must answer each question truthfully and to the best of his/her ability, but a no-one is obliged to answer any question if the answer is self-incriminating.[120]

After completing its investigation, the Competition Commission may then either refer the matter to the Competition Tribunal, if it determines that a prohibited practice has been established, or issue a notice of non-referral to the complainant.[121] However, even if such a notice of non-referral has been issued, the complainant concerned may still refer the matter directly to the Competition Tribunal.[122] The Competition Tribunal must then conduct a hearing into the matter.[123] At the conclusion of a hearing, the Competition Tribunal must make an order permitted in terms of Chapter 6, and must issue written reasons for its decision.

The mechanisms created by this act would technically allow any shareholder in a company entering into a merger of qualifying proportions, to approach the Competition Commission for an order prohibiting the implementation of a merger. Far-fetched though this may seem, authors on the subject of the shareholders rights take the following position on regulatory bodies and the protection of minority shareholders:-

> 'In practice, one of the aggrieved minority shareholder's best weapons is probably that of appealing to powerful regulatory bodies ... where there are considerations of competition ...'[124]

The considerations of the Commission will, however, be based, not on the interests of any shareholders, but on the broader interests of the South African people. The result of this is that, although a complaint to the Competition authorities may provide an innovative tool in

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[118] Competition Act 89 of 1998:s 44.
[119] Competition Act 89 of 1998:s 45(1).
[120] Competition Act 89 of 1998:s 45(3).
[121] Competition Act 89 of 1998:s 50.
[122] Competition Act 89 of 1998:s 51.
[123] Competition Act 89 of 1998:s 52.
[124] Xuereb 1989:163.

combating unwanted mergers, it is not primarily a shareholder remedy. It is a remedy based on public interest.

It is submitted that though this mechanism may afford the desperate minority shareholder with an avenue of action, its inherent limitation in scope as an remedy granted primarily in the public interest, renders it unsuitable as a stand-alone remedy.

2.4 The principle of equal opportunity and its role in the protection of minority shareholders

Minority shareholders have been described as metaphorical lambs being led to the slaughter by the controlling shareholders of the company of which they are members. While they are essential to provide the initial capital of the company through which the company conducts its business and secures its listing on the stock exchange, they are invariably last in the queue when the company is liquidated.[125]

Another particularly vulnerable situation for minority shareholders involves the type of shift in corporate control associated with a takeover. While it is true that a shareholder subscribes to a particular corporate management upon the purchase of his/her shares, the law recognises this vulnerability and makes provision for a measure of protection when a takeover scheme is proposed and carried out.[126]

One element indigenous to most take-over regulation systems is that a take-over offer must be made to all holders of the same class of shares and that the price offered by the bidder to all holders of the same class of shares, must be the same. These two provisions are collectively known as the 'equal opportunity rule'.[127]

Though some writers have interpreted the principles of corporate equality with reference to the power of every shareholder to exercise one vote for every one share in their possession, the principle under examination here relates to equality of opportunity as described above.[128]

The equal opportunity principle may be found in several provisions in South African company law contained in either the Companies Act[129] proper, or the Securities Regulation Code[130] and

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[125] Golberg 1994:1.
[126] *Spinnaker Investments (Pty) Ltd v Tongaat Group Ltd* 1982(1) SA 65 (AD):71.
[127] Fitzsimons 1997:4.
[128] See in general Delport 281 – 290.
[129] Companies At 61 of 1973.
[130] Securities Regulation Code on Takeovers and Mergers.

relate in the main to either the figure of compulsory acquisition of minority shareholdings or the obligation to make a mandatory offer or bid.

Though both will be examined extensively below,[131] it is necessary to briefly refer to those mechanisms inherent in the relevant provisions aimed at the protection of minority shareholders.

2.4.1 Section 440 K of the Companies Act: the compulsory acquisition of minority interests in affected transactions

The provisions of section 440K have been included in the list of those statutory measures aimed at the protection of minority shareholders. It has also been the topic of some criticism on the treatment of minority shareholders. It has been denigrated as a statutory confiscation measure aimed at aiding offerors to 'round up' the last dissenting shareholders,[132] and it has been hailed as a measure affording some measure of protection through the compulsion to offer a consideration similar to that offered to the consenting majority.[133]

The most consequential protection afforded to minority shareholders in this statutory provision is the equality of consideration to be offered to minority shareholders in a takeover scheme. In addition, it provides shareholders with a statutory right to approach the court for an order that an offeror may not execute this confiscation in the manner envisaged, or at all.

2.4.1.1 Equal consideration

Section 440K of the Companies Act[134] empowers any shareholder in a target company in an affected transaction, whose shares have not been purchased by the offeror as part of the bid for control of the company, to offer his/her shares to that offeror. The offeror is then compelled by the operation of the same provisions, to purchase those shares at a consideration equal to that paid to the shareholders who have accepted the initial takeover offer.

This mechanism ensures that the minority shareholder is not left under the direction of new corporate management without the option of selling out of the company. Neither can such a shareholder be forced to ultimately sell his/her shares at a lower price resulting from the fact that a premium for corporate control has already been absorbed by the majority shareholders.

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[131] See 3.3 and 3.4 below.
[132] Golberg 1994:2.
[133] Hurter 1996:400; Meskin 1994:984.
[134] Companies Act 61/1973.

2.4.1.2 Special protection afforded to dissenting minority shareholders

Should the equal consideration paid in this manner ultimately not be to the liking of the remaining minority shareholders, they are also statutorily afforded the opportunity to approach court for an order directing that their shares not be acquired by the offeror or that the consideration payable be adjusted.[135]

Though some criticism has been levied at the effectiveness of such an action, provision is nonetheless made for an additional measure of protection for minority shareholders, which will be discussed in detail below.[136]

2.4.2 The Securities Regulation Code on Takeovers and Mergers

From the discussion on the means available in South Africa to effect takeovers, it will become evident that the co-operation of the company is required to effect takeovers by such means as the scheme of arrangement procedure, the reduction of capital (or purchase of own shares) method and the redemption of redeemable preference shares method. To a lesser extent, the co-operation of the company, in the form of its majority shareholders, is required to effect a takeover by any means to any notable degree of success. Such a majority is also the majority empowered with the means to appoint the directors of a company and to veto any decision taken by such directors, where required, in general meeting.

In addition to the general common law and statutory actions described above, the role of the director has been placed central to the protection of all shareholders,[137] and the link thus established is that of the reporting system.[138] Pursuant to a world-wide move toward greater corporate reporting obligation, this move was, likewise, welcomed in South Africa.[139] The reporting obligation places a premium on the role of directors in takeovers and mergers, a role significantly underscored by the provisions of the Securities Regulation Code on Takeovers and Mergers.[140]

The Code itself contains, in addition to these obligations aimed at the benefit of the shareholders of the offeree company as a whole, a number of provisions aimed at the

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[135] Hurter 1996:400; Cilliers et al 1992:467.
[136] See 3.3.2 below.
[137] Republic of South Africa 1970:63.
[138] Republic of South Africa 1970:63; Anonymous 1993:23.
[139] Anonymous 1993:23.
[140] See, for example, the seventh general principle on which the Code is based, namely that the board of directors may take no steps aimed at the frustration of the offeror's takeover attempts not approved by the shareholders, lest they deprive such shareholders of the opportunity to make a decision on the merit of the offer.

protection of minority shareholders. It is based on a set of principles of which the most important is that all holders of the same class of securities of the target company be treated equally.[141] This principle is to be found in multiple provisions of the Code, which will be discussed below at length.[142]

2.4.2.1 Equality of opportunity

Equality of opportunity is guaranteed by a number of provisions contained in the Securities Regulation Code. It surfaces in the general principle that a mandatory offer for the acquisition of shares be made to all holders of affected securities in a takeover, a principle which is elucidated upon in Rule 8.1 as to the exact manner in which the offer is to be made. In addition, not only an equal opportunity to dispose of shares is guaranteed, but also equality of the consideration to be paid for those securities.

This equality of opportunity afforded shareholders in the provisions governing the mandatory bid is commonly regarded as minority shareholder protection.[143]

2.4.2.2 Equal consideration

While shareholder protection in the form of equal consideration provisions are limited in the Companies Act,[144] they abound in the Securities Regulation Code. It is an explicit term of the mandatory offer[145] and is also contained in the following provisions:-

a) Provisions applicable to all offers:[146]
   - i) comparable offers are to be made in instances where a company has more than one class of security;[147]
   - ii) appropriate offers are to be made for convertible or other relevant securities;[148] and
   - ii) in the case of special deals with favourable conditions;[149]

b) Conduct during the offer:[150]
   - i) equality of the information provided to shareholders.[151]

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[141] Securities Regulation Code on Takeovers and Mergers Section C:1.
[142] See 3.4 below.
[143] Brown 1999:77.
[144] Companies Act 61/1973.
[145] Securities Regulation Code on Takeovers and Mergers Section F:Rule 8.1.
[146] Securities Regulation Code on Takeovers and Mergers Section H.
[147] Securities Regulation Code on Takeovers and Mergers Section H:Rule 11.1.
[148] Securities Regulation Code on Takeovers and Mergers Section H:Rule 12(a).
[149] Securities Regulation Code on Takeovers and Mergers Section H:Rule 13.
[150] Securities Regulation Code on Takeovers and Mergers Section I.
[151] Securities Regulation Code on Takeovers and Mergers Section I:Rule 16.1.

The aim of the equal opportunity principle is clear enough, but are the origins of the obligation ultimately founded in the precepts of company law?

It is necessary to focus briefly on the law of partnership, the fiduciary duty between partners, the contents of that duty and the remedies for breach to perhaps shed some light on a possible alternative motive for equality of opportunity.

2.5 Excursus: a possible partnership foundation

A number of rights and duties exists between partners *inter se* in South African law and are categorised in a variety of manners. These rights and duties of partners include that partners are obliged to act in good faith, that they share in the profits and losses of the partnership and that partners are entitled to participate in the management of the company.[152]

This duty is not only recognised in the Roman Dutch and English legal traditions – it is also a recognised partnership duty in the American jurisprudence.[153] As such, it encompasses utmost good faith, fairness and loyalty.[154] Attention will briefly be paid to American jurisprudence as some of the principles have better crystallised in this jurisdiction.

The American Uniform Partnership Act, 1993, a model code adopted by the National Conference of Commissioners on Uniform State Laws, recognises the principle of majority rule in the day-to-day management of the affairs of the partnership.[155] As a consequence a number of rules have been developed to circumscribe the exercise of the discretion of the managing partners aimed at remedying the abuses of fiduciary power.[156] This notion is astonishingly close to that of the director's exercise of fiduciary duties under South African common law.

In addition, the notion of equality does not go unnoticed in the law of partnership in the United States. It is the primary principle which underlies partnership rights and duties[157] and, as a consequence, partners are required to share in the profits and losses of the partnership equally.[158]

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[152] Cilliers et al 2000:34 – 39.
[153] Bromberg and Ribstein 1992:6:67.
[154] Bromberg and Ribstein 1992:6:68.
[155] A 1997 version of the Act has been put forward, but does not differ substantially from the 1993 Act, save that it makes provision for Limited Liability Partnerships.
[156] Bromberg and Ribstein 1992:6:69.
[157] Bromberg and Ribstein 1992:6:70.
[158] Bromberg and Ribstein 1992:6:2.

2.5.1 The duty to act in good faith

Though the relationship between partners is primarily determined with reference to the partnership agreement, a common law duty to act in good faith exists between partners. Because the partnership is not a separate legal entity, this duty is not one due to the partnership, but a duty between the partners.[159] The existence of the business venture as a separate *legal persona* is, however, not automatically preclusive to the existence of lateral fiduciary relations between its members.[160]

The content of this duty may be broadly classified with the aid of the following constituting obligations:-

a) due acceptance and fulfillment of partnership obligations;
b) a duty not to compete with the firm;
c) a duty to guard against a conflict of interest; and
d) a duty of full disclosure.[161]

The duty has also been set out in the following terms as it relates to the law of agency:-

a) to perform partnership business;
b) to do so honestly;
c) to do so carefully;
d) to perform these duties in accordance with the implied or express authority afforded to each partner; and
e) to account to the remaining partners.[162]

The fiduciary duty of partners is codified in the United States law of partnership and is contained in the relevant provisions of the Uniform Partnership Act. The fiduciary duty places upon a partner the obligation to account for any benefit derived from a transaction connected with the partnership or from the use of its property without the consent of the other partners.[163]

It encompasses a duty of loyalty and a duty of care. The duty of loyalty, in turn, includes that a partner account to the partnership all property, profits or benefits obtained from the operation of the partnership business without the permission of the other partners, that a partner refrain from operating the business for the benefit of persons other than the partnership; and that the

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[159] Henning 1998: par 298.
[160] Ribbens 1988:245.
[161] Henning 1998: par 300.
[162] Gibson 1997:254.
[163] Bromberg and Ribstein 1992:6:71.

partner may not compete with the partnership prior to its dissolution without the permission of the other partners.[164]

2.5.2 The unselfish promotion of partnership interests

The second and third duties have been grouped together as a single requirement that a partner unselfishly promote the interests of the partnership above his/her own interests.[165] These specific duties are founded in the general principle that a partner may not acquire and retain any benefit or advantage within the scope of the partnership business as it is his/her duty to acquire such benefit for the partnership.[166] All benefits obtained in conflict of this duty must be shared with the partnership.[167]

In addition, a partner is required to guard against a conflict of interest. This entails, *inter alia*, that if a partner is confronted with the opportunity to sell partnership assets at a profit, he/she cannot in stead sell his/her share in the partnership for a private profit. A partner who does so, is obliged to account to the partnership for the premium received in excess of the value realised by the remaining partners.[168] He/she must account for the so-called 'secret profit' thus made.[169] Such a profit must then be shared with co-partners[170] even where such profit is only obtained after the dissolution of the partnership.[171]

> '[I]t is generally accepted that fair play requires that any benefit received by a partner in breach of this duty be communicated to the partnership.'[172]

American jurisprudence, too, recognises this principle in section 21(1) the Uniform Partnership Act which requires a partner to share any benefit derived from the acquisition or use of partnership property without the consent of his/her fellow partners, with the other partners.[173] The remedy for such a breach of fiduciary duty is an accounting for the benefit

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[164] Henning and Snyman 1997:692 – 694.
[165] Cilliers et al 2000:35.
[166] *De Jager v Olifants Tin 'B' Syndicate* 1912 AD 505; Sharrock 1999:391; Gibson 1997:254; Scamell and l'ansen Banks 1979:434 – 441 describes the following instances in English law where such profits must be accounted for: obtaining benefits which in honour belong to the firm as it relates to the renewal of leases, purchase of reversion, benefits derived from partnership property or from information gained as partner and benefits resulting from a connection with the firm,
[167] Henning 1998: par 300.
[168] Henning 1998: par 300; Scamell and l'ansen Banks 1979:432.
[169] De Wet & van Wyk 1978:398.
[170] *Bellairs v Hodnett et al* 1978 (1) SA 1109 (AD).
[171] Sharrock 1999:391.
[172] Ribbens 1988:27.
[173] Bromberg and Ribstein 1992:6:75.

derived which may enforced by an action in terms of section 22 of the Uniform Partnership Act.[174]

The principle seems familiar enough to specialist company lawyers: no shareholder is allowed to sell his/her shareholding at a premium without accounting to, and sharing with, the remaining shareholders. It should, however be noted that a court will ordinarily not order accounting at the instance of an individual partner during the existence of the partnership in the absence of an application to dissolve it.[175]

This principle is common to Roman-Dutch jurisprudence and that of a number of jurisdictions, and is also contained in the English 1890 Partnership Act in the following terms:-

> 'Every partner must account to the firm for any benefit derived by him without the consent of the other partners from any transaction concerning the partnership,'[176]

The fiduciary duty also encompasses a duty of full disclosure which surfaces again in the context of affected transactions in company law. If there is any particular prospect of profit, such a prospect should be brought to the notice of the other partners – they should be placed in a position where they may consider what attitude to assume with reference to the venture.[177]

This duty to observe good faith stems from the partnership as an agreement *uberrimae fidei.*[178] It encompasses a relationship of mutual trust and confidence and the breakdown of this trust and confidence may ultimately lead to the dissolution of the partnership.[179] Any material breach, which irreparably destroys the fiduciary relationship, is a good ground for terminating the partnership agreement.[180] But, as has been stated, the duty exists between partners because the partnership is not a separate legal entity that can bear its own rights and duties.[181]

This specific aspect of the fiduciary duty must not be too readily matched to the prohibition on secret profit laid upon the shoulders of the company director. That duty is owed in the first instance to the company and results in the second instance from the office of director and not to the incidence of membership.

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[174] Bromberg and Ribstein 1992:6:92.
[175] Gibson 1997:254.
[176] Partnership Act 1980:s 29(1).
[177] Henning 1998: par 300; See also Sharrock 1999:392.
[178] Henning 1998: par 300; Ribbens 1988:26; Scamell and I'ansen Banks 1979:432.
[179] Henning 1998: par 300.
[180] Sharrock 1999:397.
[181] De Wet & van Wyk 1978:393.

The presence of a fiduciary duty indicates an obligation to either protect or further the interests of the subject of the duty. From this broad duty stems a number of conjunctive duties such as those prominent in the law of partnership.[182]

2.5.3 Shareholder remedies based on breach of fiduciary duty

It has been mentioned that the alternative to the application for the appointment of an inspector under section 252 of the Companies Act,[183] is an application that the company be wound up because it is just and equitable.[184] The court will normally grant such an order for the winding up of the company in terms of section 344(h)[185] due to the disappearance of the substratum of the company, when it becomes impossible to carry on the business of the company or due to a lack of probity in conducting the affairs of the company. In addition, such an order can be granted where there were fraudulent or deceptive motives in respect of the formation of the company, or on grounds analogous to those for the dissolution of partnerships.[186]

It is in the instance of the last-mentioned circumstance, grounds for dissolution analogous to those for the dissolution of partnerships, that the separation between company law and the law of partnership becomes blurred, not least because the distinct provisions relate to the relationship of the members inter se, albeit it only in certain types of companies. The Van Wyk de Vries Commission similarly acknowledged the parallel features of the small private company and the partnership.[187]

In small companies with a few members, the court will have regard to the personal relationship between the members of the company and will grant dissolution if there is proof of a dispute, which upsets this personal relationship. Such a relationship is categorised as a relationship analogous to that between partners which requires that members act honestly and reasonably towards each other.[188]

> 'there exists between the members in regard to the company's affairs a particular personal relationship of confidence and trust similar to that existing between partners in regard to the partnership business.'[189]

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[182] Farrar 1993:384.
[183] Companies Act 61 of 1973.
[184] Meskin 1994:477.
[185] Companies Act 61 of 1973.
[186] *Rand Air (Pty) Ltd v Ray Bester Investments (Pty) Ltd* 1985 (2) SA 345 (W).
[187] Republic of South Africa 1970:63.
[188] Cilliers et al 1992:503.
[189] *Moosa NO v Mavjee Bhawan (Pty) Ltd. Et al* 1967 (3) SA 131 (TPD):137.

The remedy provided by way of winding up a company on the grounds that it is just and equitable has systematically been recognised as one useful to the protection of minority shareholders.[190] An order for the winding up of a company may be granted when the court finds that the relations between the parties have deteriorated to such an extent that all hope of future co-operation between them is precluded.[191]

Likewise, the link between partnership law and company law in this regard has been acknowledged, [192] and there exists a veritable core of findings to that effect:-

> 'I think it right to consider what is the precise position of a private company such as this and in what respects it can be fairly called a partnership in the guise of a private company.'[193]

> '... ought not precisely the same principles apply to a case like this where in substance it is a partnership in the form or the guise of a private company?'[194]

Some authors have remarked on the availability of an essentially partnership remedy in such extreme circumstances, and the refusal to apply it in less superlative instances of conflict between the members of a company.[195]

Rather ironically, a shareholders' agreement may be concluded prohibiting a shareholder party to that agreement from approaching the court for an order winding up the company on the ground that it is just and equitable to do so. In such instances, despite a breakdown in the working relationship of the quasi-partners, he/she will be required to comply with the provisions of the shareholder agreement.[196]

This is, however, an obligation incumbent on the shareholders of the company *inter partes*. As will be seen in the discussion below, the primary mechanisms aimed at the protection of minority shareholders is not the imposition of such an obligation – it is rather the imposition of an obligation upon the offeror in an affected transaction.

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[190] Hill 1992:91 – 92.
[191] Ribbens 1988:178.
[192] *Re Yenidje Tobacco Co. Ltd* [1916] 2 Ch. 426; *Ebrahimi v Westbourne Galleries Ltd* [1973] A.C. 360.
[193] *Re Yenidje Tobacco Co. Ltd* [1916] 2 Ch. 426:429.
[194] *Re Yenidje Tobacco Co. Ltd* [1916] 2 Ch. 426:432.
[195] Ribbens 1988:1-2.
[196] *Theron v Phoenix Marketing (Pty) Ltd (Heyman intervening)* 1998. (4) SA 287 (w); Sher 1999:160-161.

2.5.4 The evolution of the incorporated company in the British system

The company has been described as having been, in the early years after its inception, no more that a step removed from the partnership.[197] It developed from the equitable joint stock company via the incorporated joint stock company. In the last mentioned form of business enterprise, provision was made that the members may regulate their contractual relationship through the provisions in the articles and memorandum to which they were considered signatories (and still are today). Among other things, they could determine that the nature of the relationship was fiduciary in character. From this, some say, developed the belief that the members of an incorporated company do not stand in a fiduciary character *inter se*.[198]

The Joint Stock Companies Acts[199] were followed by consolidated Companies Acts.[200]

Current English jurisprudence recognises the so-called quasi-partnership company and applies specialised rules relating to the protection of shareholders based on the close relationship constructed in this manner.[201]

2.5.5 A duty to act in good faith between shareholders?

As a rule, members of a company stand in a contractual relationship towards each other.[202] This relationship is constructed by means of the statutory provisions relating to the signatories to the articles and memorandum of any incorporated company.[203] As has been indicated above,[204] a number of the actions are available in instances where a member's rights in terms of the company constitution have been infringed upon.[205] This relationship exists not only between the members and the company, but also between the members *inter partes*.[206]

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[197] Schreiner 1979:206.
[198] Ribbens 1988:51.
[199] Joints Stock Companies Act 1844; Joint Stock Companies Act 1856.
[200] Companies Act 1862; Companies (Consolidation) Act 1908; Companies Act 1948; Companies Act 1980.
[201] Van Rooyen 1989:708.
[202] Cilliers et al 2000:111. Xuereb 1989:12 In English company law the constitution of the company is known as the statutory contract – one of the primary sources of shareholders' rights. Section 14 of the 1985 Companies Act contains the following provision: 'Subject to the provisions of the Act, the memorandum and the articles shall, when registered, bind the company and the members thereof to the same extent as if they had been respectively signed and sealed by each member, and contained covenants on the part of each member to observe all the provisions of the memorandum and of the articles.'
[203] Companies Act 61/1973: s 65(2).
[204] See 2.2 above.
[205] Van Rooyen 1986:195.
[206] Cilliers et al 1977:36 – 37. See especially the comment made by Farrar 1993:384 that "It is fashionable today for economists to regard the company or the corporate fund as a nexus of contracts between the various groups which facilitates the raising of capital devoted to certain

In addition, it is possible for shareholders to conclude a shareholders' agreement aimed at the regulation of the exercise of powers within a company.[207] It is also possible to make provision for the protection of minority shareholders, but, even though the purpose as such may be manifest, specific issues relevant to the minority shareholders can only be resolved by clear contextual and verbal agreement on the issues.[208] Such an agreement is only valid by those shareholders who are signatories to it, and not, like the constitution, on all shareholders.

As a general rule, no fiduciary duty exists between the members of a company.[209] Some exceptions to this rule have been made in extreme and apposite instances where entrepreneurs employ the company as a vehicle for a venture, outside of the context of liquidation on the ground that it is just and equitable to do so:-

> 'We think that the analogy of a partnership to the relationship ... is an apposite and true one. That they chose the form of a company to give effect to and carry out that relationship does not affect the existence, nature or extent of any fiduciary duty ... . Since the principles of equity underlie a fiduciary duty we think that the substance of their relationship and not the form in which it was cast must be looked at to ascertain its existence, nature and extent.'[210]

The subtext is clear: in certain instances, and most notably when it is equitable to do so, the court will apply the principles of the law of partnership to the relationship between the members of a company.

The only other front on which shareholders meet to do battle with corporate management on the affairs of the company, is the general meeting.[211] This study will, below,[212] focus briefly on the extent to which the general meeting of shareholders plays a role in corporate combinations and affected transactions.

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ends. The contract approach is also used to formulate the rational scope of fiduciary obligations.

[207] Murphy 1992:25.

[208] *LSA UK Ltd and Others v Impala Platinum Holdings Ltd and Others* Unreported judgment of the Supreme Court of Appeal of South Africa delivered 28 March 2000 Case no 222/98:31.

[209] Ribbens 1988:208.

[210] *Bellairs v Hodnett et al* 1978 (1) SA 1109 (AD):1130. This judgment was, however, delivered in a case in which the shareholders had executed a shareholders' agreement that significantly influenced the judgment of the court.

[211] See for instance Stewart 1973:96 on the 1926 Companies Act 'There has been ... a tendency ... for the general meeting to be regarded as an organ thrust upon the company by the provisions of the prevailing companies statute in order to satisfy some vague notion of corporate democracy ...'.

[212] See 3.2.3 and 3.3.4.6.

2.6 Conclusion

It is clear that, aside from diversionary tactics, such as lodging complaints with the competition authorities, few of the typical minority shareholder remedies offer the type of protection that may be required by shareholders in affected transactions. It appears that the notion of equal opportunity may provide a more true mechanism for the protection of minority shareholders.

Some authors maintain the outdated notion that the company is a partnership in essence of which the shareholders are partners.[213] It is tempting to draw from this and from the effect of the application of the broader equal opportunity principle, the conclusion that the remedy is based on the partnership duty to account for all profits made from the business of the entity. It is, however, submitted that this is not the correct conclusion.

The remedy is not founded in the law of partnership, but neither, it is submitted, is it founded in the traditional minority shareholder protection mechanisms provided for in the Companies Act.

It is submitted that the partnership analogous remedies that may be found in company law are primarily applicable to the small private company. While these notions may be utilised in the case of such companies, it is submitted that they are unsuitable to the large public company and large private company to which the Securities Regulation Code typically applies.

One commentator on securities law has tendered the following proposition and conclusion on the substantive issues in securities law:-

> 'Capital markets should be 'regulated' by specially made rules, not by judge-made common law (which is too imprecise for regulators in not articulating the responsibilities of the regulated and for the regulated to order their behaviour).'
>
> 'Abolish the common law in its application to capital markets.'[214]

While the exact content of these statements cannot be supported, the general submission that special rules should be applicable to market regulation, can. It is submitted that the protection of minority shareholders should be justifiable on broad considerations of equity or

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[213] *Dadoo Ltd and others v Krugersdorp Municipal Council* 1920 AD 530:573; Gibson 1997:267.
[214] Nelson 2000:60.

on such necessities as the protection of investor confidence – not on a transference of partnership principles to the sphere of takeovers and mergers.

The following chapter of this study will focus on the law specially formulated for the capital markets and will seek to establish whether or not it indeed succeeds in articulating the responsibilities of the regulated sufficiently.

CHAPTER 3

THE LAW IN THE UNITED STATES

3.1 Introduction

Most of the jurisdictions to be considered in this study, have a common foundation in the British company law tradition. The majority of principles developed (albeit in somewhat different directions) from principles and doctrines such as the rule in *Foss v Harbottle* and the tenets of the City Code on Takeovers and Mergers, on which not only the South African Securities Regulation Code on Takeovers and Mergers is based, but also, to a significant extent, the proposed Thirteenth Directive.

American jurisprudence presents a radical departure from this tradition. It is, however, necessary to attempt to trace similar constructs in the law of the United States. Due to the singular nature of the American legislative system in this field, broad principles will be traced and analysed with due recognition of the relative status of those principles. While securities law is regulated at federal level, corporations laws are enacted by state legislatures and consequently differ widely. The proposals contained in Model Business Corporations Act will be studied where applicable, but reference will also be made to specific state laws where some principles are more clearly elucidated in those statutes. Selected state precedents will be examined where they serve to highlight certain propositions. A significant portion of the analysis done below is based on Delaware law. Delaware case law is, however, persuasive to courts in jurisdictions in which case law on the topic concerned is absent.[1] It has, after all been noted that:

> 'American corporate law is not an exact science. Rather, it is a set of loosely defined guidelines made concrete by courts after the fact.'[2]

The development and origin of the principles discussed are of primary importance to the conclusions to be reached in this study, which will focus, *inter alia*, on a possible rationale for the provisions enacted in other jurisdictions. The study of the law in the United States will commence with an examination of the fiduciary duty that may exist between shareholders through an analysis of the judicial precedents *Perlman v Feldman*[3] and *Jones v HF Ahmanson & Company*,[4]

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[1] Torres 1986:369.
[2] Kamar 1999:887.
[3] 219 F 2d 173, 175 (2d Cir), cert denied, 394 US 952 (1955).

and the proposals developed from that notion. The development of the principle of equal opportunity will also be examined with reference to its development from the theories surrounding the payment of control premiums in takeovers.

Against this developmental setting, the regulation of takeovers and mergers in the United States will be discussed with specific reference to the different forms of corporate combination. The approval required for the varying forms of corporate combination impacts on the approval required for such combinations and, through that requirement, on the protection available to minority shareholders. The peripheral safeguards included in securities regulation will also be reviewed in so far as it is relevant to minority shareholder protection.

The exact risk to which minority shareholders in the United States are exposed, will be studied in conjunction with the right of appraisal as a primary remedy for certain shareholders and the attendant fair price remedies and broader tests for fairness in transactions. The mandatory bid, in as far as it has been introduced into American law will also be reviewed.

Ultimately, other methods of protecting minority shareholders, both through internal arrangements and by statutory means will be examined.

3.2 A fiduciary duty between shareholders

The familiar right of a shareholder to exercise his/her right in any manner he/she deems fit has been altered:-

> '... a shareholder may exercise wide liberality of judgment in the matter of voting, and it is not objectionable that his motives may be for personal profit, or determined by whims or caprice, so long as he violates no duty owed his fellow shareholders.'[5]

In British company law derivative systems, the only relationship between shareholders is contractual and stems from the fact that they either are, or are considered to be, signatories to the articles of incorporation and memorandum of association of the company. One exception to this is Australian jurisprudence which recognises a fiduciary duty owed to minority shareholders by those shareholders in control of the company which extends only as far as that those

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[4] 1 Cal 3d 93, 81 Cal Rptr 592, 460 P2d 464 (1969).
[5] Torres 1986:364 quoting the judgment of the court in *Singer v The Magnavox Co.* 380 A.2d 969 (1977).

shareholders are obliged to exercise their votes bona fide and in the best interests of the company.[6]

This is not the case in American jurisprudence in which the fiduciary duty between shareholders, when constucted in certain circumstances, renders a significant contribution to the protection of minority shareholders. This reasoning has been (somewhat skeptically) phrased as follows:-c

> 'Fiduciary principles require fair conduct; equal treatment is fair conduct; hence, fiduciary principles require equal treatment.'[7]

Simplistic as this argument may seem, it is necessary to examine the origins of this reasoning. In the previous chapter of this study the notion of the fiduciary duties between partners was discussed in anticipation of the notion of the fiduciary duty between shareholders. There is was concluded that such constructs are not apposite to the modern less closely held private company and the public company. It has, however, been expressly said that large corporations in America have long outgrown the 'incorporated partnership' phase.[8]

3.2.1 Perlman v Feldman

The case of *Perlman v Feldman*[9] presents some authority for the primary contention that a fiduciary duty exists between shareholders and is hailed as the *locus classicus* for the equal opportunity rule as it developed in American law.

The judgment was given pursuant to a derivative action brought by the minority shareholders of the offeree company. The action was based on the sale (at a significant premium) of the controlling interest by the dominant shareholder and chairman of the board of directors of the company which, the minority shareholders contended, amounted to compensation for the sale of a corporate asset.

The fiduciary duty owed by a director to the company is a well-known construct in South African and English jurisprudence, but in this judgment of the comparable law in the United States, the court expressly constructed a fiduciary duty between shareholders:-

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[6] See the discussion at 6.2 and the broader discussion at 2.2 at footnote 4.
[7] Easterbrook and Fischel 1982:703.
[8] Berle 1958:1212.
[9] 219 F 2d 173, 175 (2d Cir), cert denied, 394 US 952 (1955).

'Both as a director and as a dominant stockholder, Feldmann stood in a fiduciary relationship to the corporation and to the minority shareholders as beneficiary thereof.'[10]

In addition, the court heeded the nexus between majority shareholding and the ensuing power to elect the directors to construct a situation in which the majority shareholder is held to have assumed the liability of the directors.

The most significant aspect of this judgment, for purposes of this study, though, is the application of the principle that a fiduciary (like a partner) must account to his fellow members for any profit derived from the business of the undertaking:-

'The actions of defendants in siphoning off for personal gain corporate advantages to be derived from a favourable market situation do not betoken the necessary undivided loyalty owed by the fiduciary to his principal.'[11]

The court then extended such a profit made from the business of the undertaking to the sale of controlling interests in certain circumstances:-

'We do not mean to suggest that a majority stockholder cannot dispose of his controlling block of stock to outsiders without having to account to his corporation for profits or even never do this with impunity when the buyer is an interested customer, actual or potential for the corporation's product. But when the sale necessarily results in a sacrifice of this element of corporate good will and consequent unusual profit to the fiduciary who has caused the sacrifice, he should account for his gains.'[12]

The court found in favour of the plaintiffs and remanded the action for further proceedings:[13]

'Hence to the extent that the price received by Feldmann and his co-defendants included such a bonus, he is accountable to the minority shareholders who sue here.'[14]

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[10] *Perlman v Feldman* 219 F 2d 173, 175 (2d Cir), cert denied, 394 US 952 (1955):953; Andrews 1965:508.
[11] *Perlman v Feldman* 219 F 2d 173, 175 (2d Cir), cert denied, 394 US 952 (1955):956. See also Clarke 1986:254.
[12] *Perlman v Feldman* 219 F 2d 173, 175 (2d Cir), cert denied, 394 US 952 (1955):957.
[13] *Perlman v Feldman* 219 F 2d 173, 175 (2d Cir), cert denied, 394 US 952 (1955).
[14] *Perlman v Feldman* 219 F 2d 173, 175 (2d Cir), cert denied, 394 US 952 (1955):958. Though the suit is derivative in character, the court took the unusual step of ordering that compensatory

This judgment was reported in 1955, imposing the obligation to divide the premium paid for control of a company equally between all of its shareholders. This obligation was based not on statute but on a fiduciary relationship between shareholders and the obligation to divide the premium was imposed on the seller of the controlling interest and not on the acquirer of that interest.[15]

Though this view was supported in some states, it never developed into a fully fledged obligation.[16]

3.2.2 The argument of Professor Andrews

Subsequent to this judgment, an argument in favour of a broad equal opportunity rule was put forward. Professor William D Andrews constructed his argument, primarily from the facts of and findings in the case of *Perlman v Feldman* discussed above.[17] From these he distilled a proposal which is central to this study:

> 'Whenever a controlling shareholder sells his shares, every other holder of shares (of the same class) is entitled to have an equal opportunity to sell his shares, or a prorata part of them, on substantially the same terms.'[18]

Distilled even further, this rule has two primary implications. Firstly, a shareholder retains the freedom to dispose of shares at any price, provided that he/she cannot sell on terms more favourable than those offered to fellow shareholders. Secondly, a prospective offeror is not compelled to make an across-the-board offer to all shareholders. Instead, any offer that is made, must be made proportionally to all shareholders.[19]

In addition, the rule is only operative to the extent that it will hamper a sale of a controlling interest, in the following circumstances:-

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payment be made directly to the minority shareholders. See also the discussion of Clarke 1986:484.

[15] See also Clarke 1986:484; Courtright 1985:70.

[16] *Jones v HF Ahmanson & Company* 1 Cal3d 93, 81 Cal Rptr 592, 460 P2d 464 (1969). See also Clarke 1986:487 – 488 and *Brown v Halbert* 76 Cal Rptr. 781 (Cal. App. 1969) in which the court developed the so-called 'special facts' doctrine which requires that special facts exist before the court will extend the fiduciary duty of the major shareholder-director past the corporation to the minority shareholders of the company.

[17] Andrews 1965:506.

[18] Andrews 1965:515. See also the discussion by Courtright 1985:70.

[19] Andrews 1965:516.

a) when the purchaser is unwilling to purchase additional shares;

b) when the controlling shareholder as seller insists on disposing of all his/her shares; and

c) when the minority shareholders in the company are unwilling to stay in the company once it is under the control of the offeror.[20]

This rule is quite pragmatically analysed by Professor Andrews from three viewpoints relating to the advantages and disadvantages of the rule, namely the practical viewpoint, the economic viewpoint and the theoretical viewpoint.

Under the practical advantages of the rule as proposed, are listed the following:-

a) the substantial danger that, following a transfer of control those shareholders who did not have the opportunity to sell their shares, will be treated detrimentally, is substantially avoided;[21]

b) the loss of a favourable opportunity to sell corporate assets or effect a merger, is avoided;[22] and

c) shareholders are empowered to share equally in the profits of the enterprise as a sale of shares is an important manner in which shareholders realise such profits.[23]

Economically, the primary defence of the rule is founded in the prevention of looting.[24] The primary motive for obtaining controlling shareholding at a premium is the prospect of selling assets in the process of looting. Levying a higher premium through requiring an equal opportunity in the sale of shares should, economically, discourage looters through making the purchase of control more expensive.[25]

In addition, Andrews argued that, economically speaking, an investment in a controlling interest in a company is safer that an investment in minority shares. The lesser risk attached to such an investment would merit the extra expense to be incurred by the implementation of the proposed equal opportunity rule.[26] It would also eliminate the situation brought about in instances where the controller-to-be has little more resources than is required to acquire the controlling interest.[27]

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[20] Andrews 1965:517.
[21] Andrews 1965:517.
[22] Andrews 1965:519.
[23] Andrews 1965:521.
[24] See also the discussion by Clarke 1986:495.
[25] Andrews 1965:522 – 523.
[26] Andrews 1965:526 – 527.
[27] Andrews 1965:533.

The theoretical considerations put forward by Andrews are familiar from the English-derivative systems outlook on the protection of minority shareholders: absent any harm to the corporation, the shareholders cannot be injured – a concept related to the notion that shareholders owe each other no fiduciary duties. The only reason this would not be the case, is if the strict view of the corporation as a separate entity would be unequivocally adhered to.[28]

It is submitted that the link between the law of partnership and the notion of equality of opportunity in sale-of-control-transactions emanate from this:-

> 'One answer to this objection is simply to reject the separate entity notion as a true or useful description of corporate relationships. A corporation, like a partnership, is essentially nothing more or less than the people who make it up, associated for the operation of a common business enterprise.'[29]

This separate entity theory, Andrews contends, fails shareholders in control-transactions because it does not address the question of fairness in share transactions.[30]

Andrews also developed a number of qualifications to the equal opportunity rule proposed. It was suggested that the rule only apply in transactions where controlling interests were sold. Whether or not a sale of stock would be recognised as such a sale of controlling stock would depend on whether or not the offeror would be willing to pay a premium for the acquisition of such shares. Finally, the rule would not be applicable in instances where there is an established market for the shares of the corporation[31] and the minority shareholders are able to dispose easily of their shares.[32]

Ultimately the remedies for breach of the rule were also examined by Andrews. It would primarily be possible to compel an offeror to acquire shares not acquired on substantially the same terms as were afforded to the seller of the controlling interest which triggered the rule.[33]

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[28] Andrews 1965:538.
[29] Andrews 1965:538.
[30] Andrews 1965:545.
[31] The so-called stock market exception to the equal opportunity rule is discussed below. One is tempted to ask whether or not this exception developed directly from Andrews stated exceptions or not.
[32] Andrews 1965:545 – 550.
[33] Andrews 1965:551.

3.2.3 Jones v HF Ahmanson & Company

The judgment delivered by the court in the case of *Jones v Ahmanson*[34] confirmed the principle that the majority shareholders owe a fiduciary duty to the minority shareholders of that company:

> 'The Court of Appeal have often recognized that majority shareholders, either singly or acting in concert to accomplish a joint purpose, have a fiduciary responsibility to the minority and to the corporation to use their ability to control the company in a fair, just, and equitable manner. Majority shareholders may not use their ability to control corporate activities to benefit themselves alone or in a manner detrimental to the minority. Any use to which they put the corporation or their power to control corporate activities must benefit all shareholders proportionately and must not conflict with the proper conduct of the corporation's business.'[35]

The test laid down for the conduct of the majority shareholders, however, was whether or not the comprehensive rule of good faith and inherent fairness to the minority in any transaction in which the control of the corporation is material had been obeyed. Majority shareholders can be called to account where they received a gain that can reasonably be traced to their abuse of the controlling position. In this manner the court came to the conclusion that the minority shareholders were at their election entitled to receive either the appraised value of their shares on the date on which the controlling shareholders effected the particular corporate combination transaction. In addition, such shareholders were also entitled to interest or a sum equal to the fair market value of the shareholding they would have been entitled to, had they been invited and allowed to participate in the corporate combination in the same manner as the former majority shareholders. In this manner the minority shareholders would have been placed in a position at least as favourable as the one the majority shareholders had created for themselves.[36]

3.2.4 Conclusion

The theory of fiduciary duty in sale-of-control transactions and the control-theories on which they are based, received serious academic and judicial attention from the 1950's to the late 1970's[37]

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[34] *Jones v HF Ahmanson & Company* 1 Cal3d 93, 81 Cal Rptr 592, 460 P2d 464 (1969).
[35] *Jones v HF Ahmanson & Company* 1 Cal3d 93, 81 Cal Rptr 592, 460 P2d 464 (1969):471.
[36] *Jones v HF Ahmanson & Company* 1 Cal3d 93:476.
[37] Hazen 1977:1024 – 1025.

and judicial enforcement of these duties provided some open-ended protection for minority shareholders.[38]

In subsequently delivered judgments such as *Zetlin v Hanson Holdings, Inc.*[39] courts however rejected the notion of any fiduciary duty absent instances of looting of assets and fraud.[40] This development presents some correlation between legal development in both the United States and South Africa. While there is some tolerance for the application of such principles in the small, closely held company, such application is not readily transposed to the large, publicly held corporations.

The enactment of enabling legislation for limited liability in the United States may, however, have re-opened the debate. One of the classic fears of the minority shareholder is that he/she will be frozen out of the corporation, a pattern of behaviour that has frequently occurred among members of closely held corporation, too. Currently one of the only remedies avaliable to a shareholder in such a corporation who finds him/herself in such a situation is one for breach of fiduciary duty.[41]

3.3 An equal opportunity rule based on the control theory

As early as 1932, it was suggested that control is a corporate asset and that any price paid for such control was to go into the corporate treasury. This argument was based on the fact that the value of control arises from the ability that the holder has to dominate the property which, in equity, belong to others. This argument was extended to a proposal for a rule in which the proceeds of a sale of any shareholding carrying control belongs not to the seller but to the corporation and, perhaps, to all shareholders pro rata.[42]

3.3.1 A premium for control?

One of the fundamental considerations in this section of American jurisprudence related to the premium that potential offerors may be willing to pay for control of the company. It has been argued, for instance, that the only two reasons an offeror would be willing to do so, would be to

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[38] Thompson 1995:2.
[39] 48 N.Y2d 684, 397 N.E.2d 387 (1979).
[40] Hazen 1985:248 – 249.
[41] Crago 1996:1 – 2; Gevurtz 1995:498 – 5000.
[42] Berle 1958:1220. See also the discussion of Clarke 1986:491 – 492.

enhance the value of the company or to establish some form of non-shareholder relationship with the target company, such as that of a preferential supplier.[43] This is, however, not the only motivation for doing so: the darkest form of the non-shareholder relationship would be the company looter who aims to engage in unfair self-dealing.[44]

A number of states have passed legislation aimed at the regulation of control share premiums. Some of these statutes provide that an acquirer passing a certain threshold of shareholding, forfeits the right to vote until such rights are restored by a vote of the remaining shareholders.[45] These provisions do not limit the purchase of control, but suspend the exercise of that control.

Federal securities laws have also placed a ban on premiums if the acquisition of control is effected by means of a tender offer. While there are benefits attendant to such restraints, it has also been argued that:-

> 'those who produce a gain should be allowed to keep it, subject to the constraint that the other parties to the transaction be at least as well off as before the transaction.'[46]

Another view of control premiums is that it has a spill-over effect on the fair value of shares afforded to dissenting shareholders in corporate control transactions. According to this school of thought, so-called 'minority discounts' are brought into consideration in valuing shares for purposes of the appraisal remedy.[47]

3.3.2 A duty to share

The notion of the sale of control as a corporate asset has also been developed with more focus on the expectations of the minority shareholders in companies where such sales of control occurred. It is framed as an expectation of many business people and corporate lawyers that:-

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[43] Clarke 1986:495. See also the discussion by Little 1997:9.
[44] Clarke 1986:496.
[45] See for instance section 23-1-42-1 of the Indiana Code as discussed in the case of *CTS Corp v Dynamics Corp of America* 481 US 69, 95 L Ed 2d 67, 107 S Ct 1637 (1987); Hamilton 1998:1011.
[46] Easterbrook and Fischel 1982:698.
[47] Coates 1999:1262 – 1265; Wertheimer 1998:641 – 642.

> '[W]hen the dominating shareholder receives an offer to purchase a controlling interest it should be communicated to the other shareholders and they should be given an opportunity to deal on an equal basis.'[48]

This returns to the 1965 suggestion that a rule embodying the principle of equal opportunity in the sale of shares be introduced in the following terms:-

> '[W]henever a controlling stockholder sells his shares, every other holder of shares (of the same class) in entitled to have an equal opportunity to sell his shares, or a pro rata part of them, on substantially the same terms. Or ... before a controlling shareholder may sell his shares to an outsider he must assure his fellow stockholders an equal opportunity to sell their shares, or as high a proportion of theirs as he ultimately sells of his own.'[49]

The equal treatment of shareholders has, more recently, been extended by some authors on the topic to realm of all corporate distributions and reorganisations.[50] Accordingly, the equal treatment of all shareholders is required upon the liquidation of a corporation and the distribution of assets,[51] not least to protect minority shareholders against distribution which would lead to losses for them alone.

This study is, however, limited to takeovers and mergers and the protection of minority shareholders in a company subject to a change in control.

In the realm of takeovers and mergers the first question to be posed relates to the merging of a parent and subsidiary company and distribution made to the stockholders in the subsidiary company prior to its dissolution or merging. Though it appears that disparate treatment of minority shareholders is allowable under state merger statutes, it seems that substantive disparity is not permissible.[52]

When the scope of these takeovers and mergers is extended to so-called third party transactions, the emphasis shifts to the equal distribution of the premium paid for control of the company among the shareholders of the target company.[53]

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[48] Jennings 1956:31.
[49] Andrews 1965:515.
[50] Brudney 1983:1073.
[51] Brudney 1983:1079 – 1080.
[52] Brudney 1983:1099.
[53] Brudney 1983:1115.

In the acquisition of a controlling interest from the controllers of the company, it has been argued, as it has been in South African law, that the application of equal opportunity provisions makes takeovers expensive.[54] In American jurisprudence this is quantified with reference to the fact that the acquiring party may ultimately be compelled to pay more for the company than the assets of the company are worth.[55]

This argument may be refuted when it is taken into consideration that an offeror seeking control of a company may very well have been induced to pay the whole of the premium to the parties selling control, were he/she is not under an obligation to adhere to a rule of equal treatment.[56]

In the acquisition of a controlling interest from the public, a different dispensation is envisaged. This situation refers to the so-called 'two-step' takeovers in which the offeror first makes a bid for control of the company, and then attempts to purchase the remaining shares of the company. Normally, the offeror will attempt to pay less for the remaining shares that was paid for the initial acquisition.[57]

Formally, it should make no difference to the minority shareholder who is in control of the company. Substantially, however, the transfer of control results in a new controller-manager with the result that the enterprise originally invested in, is no longer the same.[58] Without their consent the minority shareholders are now compelled to participate in a new enterprise: it is in fact 'frozen in', without having shared the benefit of the opportunity of stepping out of the company.[59]

The Williams Act contains the aptly named 'pro rata' rule which functions in the following manner: If a bidder offer to purchase only a portion of the outstanding shares in the target company, and the holders of those shares tender more shares than the number the bidder has offered to buy, the bidder must purchase shares in the same proportion from each shareholder.

The notion of equal treatment has, however, found its way into the determination of fair value of shares in appraisal proceedings. In the state of New York the courts have held that this notion mandates that all shares have equal value determined according to the value of the company in question.[60]

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[54] See the discussion at 7.6.2.2.
[55] Brudney 1983:1115.
[56] Brudney 1983:1125.
[57] Brudney 1983:1122.
[58] Brudney 1983:1123.
[59] Brudney 1983:1122.

3.3.3 In favour of a general equal opportunity rule

The proposal for the introduction of a general equal opportunity rule has been opposed on a number of grounds. It has been argued that takeovers will become so expensive as to be almost impossible to finance and that the obligation to extend an offer to all shareholders would impede an offeror's attempts at diversification of his/her own investments. In addition, it has been put forward that the equal opportunity rule would not, *per se*, discourage looters significantly.[61]

The counter-argument to the first objection has been described above: there is no empirical evidence to that effect.[62]

3.3.4 The mandatory bid in the United States

In the United States, there is no general requirement that a bidder who acquires a substantial shareholding in a target company make an offer for the remaining shares in the target. Two states, Maine and Pennsylvania, have, however, enacted statutes that require a substantial holder to purchase all outstanding shares at a statutorily determined fair price.[63]

As an example of the American structuring of the bid, section 910 the Maine Business Corporations Act will be studied. Of primary importance is the fact that the application of the remedy thus provided, may be excluded in either the by-laws or the articles of incorporation of the company.[64]

A controlling person[65] is required to give notice of the occurrence of a control transaction[66] within 15 days of the transaction to all shareholders of the target company.[67] That notice must contain a copy of this section of the act. Shareholders are then afforded 30 days in which to demand a cash

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[60] Coates 1999:1338.
[61] Clarke 1986:497. This argument should be viewed against the background that it is motivated as a deterrent to such looters.
[62] Clarke 1986:497.
[63] Neff et al 2000:6.
[64] 13A Me. Rev. Stat. Ann. § 910 (1).
[65] A controlling person is defined in 13A Me. Rev. Stat. Ann. § 910 (2) as a person who has, or a group of persons acting in concert who have, voting power over voting shares of the corporation that would entitle the holders of those shares to cast at least 25% of the votes that all shareholders would be entitled to cast in an election of the directors of the corporation or voting power over at least 25% of the shares in any class of shares entitled to elect all the directors, or a specified number of them.
[66] A control transaction is defined in 13A Me. Rev. Stat. Ann. § 910 (3) as the acquisition by a person or group of the status of a controlling person.
[67] 13A Me. Rev. Stat. Ann. § 910 (3).

payment of the prescribed price for their shares.[68] This price is merely noted as an amount equal to the fair value of the shares taking into account all relevant factors, including an increment representing a proportion of any value payable for the acquisition of control of the corporation.[69]

Shareholders who demand such payment must then submit certificates representing their shares to the corporation for notation[70] and within ten days of the expiration of the 30 day period, the controlling person must make an offer for payment to each shareholder who demanded payment – at the same price.[71]

The fair price is initially offered at the discretion of the controlling person.[72] Should any shareholder agree to that price, payment must be made and upon payment, the demanding shareholder will cease to have any interest in the shares.[73] Should one or more demanding shareholders, however, fail to agree on the fair value of the shares with the controlling person, the controlling person may bring action in the Superior Court in the county where the registered office of the corporation is located, praying that the fair value of the shares be determined.[74]

No guidelines are, however, provided for the court in the determination of the fair value of shares. In addition, shareholders who have already accepted the offer made by the controlling person, are excluded from participation in the action.[75]

3.4 Takeovers and mergers

Corporate combinations such as takeovers and mergers are primarily regulated by the laws relating to Federal Income Tax, Securities Regulation and State Business Corporation Statutes.[76]

The primary Acts aimed at the regulation of securities are the Securities Act of 1933 and the Securities Exchange Act of 1934 as amended by the Williams Act of 1968.[77] It is necessary to

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[68] 13A Me. Rev. Stat. Ann. § 910 (4).
[69] 13A Me. Rev. Stat. Ann. § 910 (5).
[70] 13A Me. Rev. Stat. Ann. § 910 (6).
[71] 13A Me. Rev. Stat. Ann. § 910 (7).
[72] 13A Me. Rev. Stat. Ann. § 910 (7). The exact wording of the section refers to 'a specified price deemed by the controlling person to be the fair value of those shares'.
[73] 13A Me. Rev. Stat. Ann. § 910 (8).
[74] 13A Me. Rev. Stat. Ann. § 910 (9).
[75] 13A Me. Rev. Stat. Ann. § 910 (9)(D).
[76] Clarke 1986:406 - 414.
[77] It should be noted that most states enacted a series of statutes aimed at the regulation of takeovers. The so-called first generation laws, which (in an attempt to secure economic and

consider corporate combinations generally in order to reflect on the specific impact of, especially, approval requirements on the rights of minority shareholders.

3.4.1 Corporate combinations generally

American jurisprudence distinguishes broadly between two types of corporate combinations, namely merger-type transactions and sale-type transactions. Under merger type transactions are understood:-

a) statutory mergers;
b) stock-for stock exchanges;
c) stock-for-assets exchanges; and
d) triangular or subsidiary mergers.

Each of these will briefly be considered in order to frame a general background to the discussion on current the most important general shareholder remedies.

3.4.1.1 Statutory mergers

A merger may be defined as a combination of two or more corporations whereby only one corporation survives. Statutory mergers will result in the absorption of the offeree company by the offeror.[78] Such a transaction has the effect that all assets, liabilities and obligations of the offeree are transferred to the offeror.

The Model Business Corporations Act[79] details a number of general consequences of a merger. Firstly, every other corporation party to the transaction merges into the surviving corporation and subsequently cease to exist. All movable and immovable property vests in the surviving company which also assumes all the liabilities of the companies thus combined. Legal proceedings pending against any of the corporations party to the merger may either be continued as if the merger did

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employment stability) required the approval of a state official, were struck down as unconstitutional in *Edgar v MITE Corp* 457 U.S. 624 (1982) which focused specifically on the Illinois statute. The second generation laws were upheld in *CTS Corp v Dynamics Corp of America* 107 S. Ct 1637 (1987) which focused specifically on Indiana's statute. These laws required the approval of the board of directors prior to the effectuation of a takeover bid.

[78] Schneeman 1997:369.

[79] The Model Business Corporations Act is not an act as commonly understood. It is rather a suggestion for state corporations acts. It is studied here in order to view the broad principles applicable to the situations discussed.

not occur, or the surviving corporation may be substituted in the proceedings for a corporation which has ceased to exist as a consequence.

The articles of the surviving company are amended to the extent intended in the merger and the shares of each corporation party to the merger and the former holders of those shares are entitled only to the rights provided in the articles of merger or to their dissenter's rights.[80]

The approval of the boards of both the offeror and offeree companies are required and the shareholders of both the offeror and offeree companies must approve the merger by means of a majority vote.

In almost all American states, shareholders who have the right to vote on the approval of the merger will have a right of appraisal[81] - one of the primary mechanisms for minority shareholder protection.

In small-scale mergers where the offeror is significantly larger than the offeree,[82] the transaction need not be approved by the shareholders of the offeror. A second exception to the required approval is the so-called short form merger in instances where the offeror already owns 90% of the stock in the target company. In such a merger neither the shareholders of the offeror, nor the shareholders of the offeree need approve the merger.[83]

In the classic 'whale/minnow' merger the shareholders of the offeror would not be afforded appraisal rights, primarily due to the fact that they would not have been able to vote on the merger itself. In the case of so-called short-form mergers, neither the offeror's nor the offeree's shareholders would be afforded rights of appraisal.

3.4.1.2 Stock-for-stock exchanges

Stock-for-stock exchanges have more or less the same result as a statutory merger due to the fact that stock in the offeree company is exchanged for stock in the offeror company.

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[80] Model Business Corporation Act: section 11.06(a).
[81] See the discussion on appraisal rights at 6.4 below.
[82] Such mergers are referred to as 'whale/minnow' mergers. The test to be applied to determine whether or not a particular merger qualifies as a small scale merger is whether or not the completed transaction will increase the outstanding shares in the offeror by more than 20%.
[83] Bartlett 1991:256 – 257.

In such exchanges the transaction must be approved by the directors of the offeror. The approval of the shareholders of neither the offeror nor the offeree is required. Each shareholder makes an individual decision.

3.4.1.3 Stock-for-assets exchanges

Stock-for-assets exchanges encompass the issuing of offeror stock to the offeree company followed by the transfer of all the assets of the offeree company to the offeror. The offeree company is then normally dissolved after the issuing of the offeror stock to the shareholders in the place of its own stock.

In a stock-for-assets transaction the approval of the boards of both the offeror and the offeree is required. In addition, as is the case with any other disposal of the assets of a company, the shareholders of the target company must approve the sale of assets.

3.4.1.4 Triangular or subsidiary mergers

Triangular or subsidiary mergers are executed in the same manner as any of the mergers above, save that the offeror will set up a wholly-owned subsidiary for purposes of the execution of the transaction.[84]

One important consequence of such a transaction is that the shareholders of the offeror need not approve the merger.

Sale-type transactions normally entail that cash or bonds are offered to the shareholders of the offeree company in the place of stock. These transactions can take the form of either an asset-and-sale-liquidation or a stock sale or tender offer.

In triangular or subsidiary mergers both the directors and shareholders of the target company and the offeror must approve the envisaged merger. Despite these requirements, the shareholders of the offeree company alone are afforded appraisal rights in most states.

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[84] Schneeman 1997:372.

3.4.1.5 Asset-and-sale liquidation

The asset-and-sale-liquidation transaction is executed by selling all the assets of the offeree company to the offeror before dissolving the offeree company and distributing the proceeds of the sale to its members. The sale of assets requires both the approval of the board of directors and the formal approval, by a majority vote, of the shareholders of the offeree company.

Though the board of directors of the offeror company must approve the acquisition of the assets of the offeree, the shareholders need not approve such an acquisition.

In most states the shareholders of a corporation that is selling substantially all of its assets are afforded rights of appraisal, save in instances where the sale of assets is followed by a quick dissolution and the proceeds of the sale are distributed in cash form to the shareholders. In this manner, for instance, the state of Delaware awards shareholders no appraisal rights in circumstances where the company sells its assets.

Some states also deny the right of appraisal in such circumstances in instances where the shares of the company involved are traded publicly.

3.4.1.6 The stock sale or tender offer

A stock sale encompasses the acquisition of the controlling interest in the offeree company. This transaction is known as the tender offer which forms the object of the majority of regulation in jurisdictions like South Africa.

This type of corporate transaction is also described as a takeover where a takeover constitutes the acquisition of control through the purchase of a substantial number of voting shares of the corporation. The successful completion of such a transaction will enable the majority shareholder to control the acquired corporation's assets and policies.[85]

The approval of neither the board of directors nor the shareholders of the offeree company is required. Each individual shareholder merely makes the decision whether or not to sell his/her interest in the company.

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[85] Miller and Jentz 1994:756.

The completion of this acquisition may then be followed by either the dissolution of the offeree and the transfer of its assets to the offeror or the merger of the offeree with the offeror.

The basic idea underlying the provisions in corporate law is that corporate changes that affect the interests of shareholders, should be approved or consented to by the majority of shareholders.[86] The principle of equal opportunity, however, is most prevalent in the so-called corporate control transactions or transactions in which the control passes from one party to another.

Much has been said about the constitutionality of so-called second general takeover statutes which require the approval of any substantial economic transaction by the affirmative vote of the holders of two-thirds of the voting stock not owned by the offeror. An alternative to this requirement is that the shareholders receive a price per share designed to ensure that all holders receive at least the highest price per share paid by the offeror.[87] These kinds of provisions were, however, tacitly approved by the courts in the United States.[88]

3.4.2 Shareholder remedies under the Securities Act of 1933 and the Securities Exchange Act of 1934

Both the Securities Act of 1933 and the Securities Exchange Act of 1934 focus primarily on the regulatory policing of securities malpractices. The Securities Exchange Act, for instance, makes provision for overseeing and regulating the securities market, disclosure in favour of potential investors and controlling credit extended to the market place. In addition, it provides for the establishment of the Securities and Exchange Commission[89] and National Securities Exchanges.[90] These acts also seek the prevention of fraud in the trade of securities and the manipulation of such markets.[91]

Supplementary to these provisions, are the provisions relating to so-called private securities litigation contained in both the acts.[92] Both sets of provisions make provision for private class actions which may be brought by plaintiffs from disputes arising in terms of those two acts.[93]

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[86] Clarke 1986:414.
[87] Hurwitz 1988:141 – 157.
[88] See the discussion of the judgment in *CTS Corp v Dynamics Corp of America* 107 S Ct 1673 (1987) in Miller and Jentz 1994:765 – 766 and Hurwitz 1988:141 – 157.
[89] Securities Exchange Act of 1934:section 4. See also Ribstein 1992:1 – 62 for a discussion on mandatory disclosure as a means of investor protection.
[90] Securities Exchange Act of 1934:section 6.
[91] Maurelli 1998:1080.
[92] Securities Exchange Act of 1934:section 21D; Securities Act of 1933 section 27.

Additional legislation on securities litigation has been passed,[94] most recently the Securities Litigation Uniform Standards Act which is aimed at preventing lawyers from bringing cases in state, rather than federal, courts.[95]

In addition, the Securities and Exchange Commission has amended the rules relating to shareholder proposals, raising the dollar value of shares that have to be owned by a shareholder to qualify him/her for the submission of a shareholder proposal.[96]

The Securities Exchange Act of 1934 makes additional provision for the requirements for securities fraud actions.[97] These two statutes, however, afford no protection to shareholders in the instances of corporate mismanagement, misconduct or breaches of duties to shareholders. They relate only to fraud or manipulation in the purchase or sale of securities.[98]

3.4.3 The Williams Act and shareholder protection

The Williams Act was enacted in 1968[99] combining full disclosure obligations with a set of rules of 'fair play'.[100] The provisions of the act, enacted as an amendment of the 1934 Securities Exchange Act, seek to level the field between the offeror and the offeree and to protect shareholders against unfair and deceptive practices.[101]

Protection is provided through the elimination of the advantages of surprise so as to enable shareholders to make a reasoned and informed decision as to the offer being made to them. Section 13(d), for instance, requires and person acquiring more than 5% of the voting shares in a company to make a public filing.[102] Such a filing must contain information pertaining to the individual or organization making the acquisition and must provide details regarding the financing arrangement behind the purchase. In addition, their intention regarding the corporation involved,

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[93] The efficacy and damages recovered employing those mechanisms have, however, repeatedly been questioned. See Cox 1995:5 – 6; Grossman 1999:47 – 49 and Mundheim 1999:56.
[94] See, for instance, the Private Securities Litigation Reform Act of 1995.
[95] ABA Subcommittee on Annual Review 1999:836.
[96] ABA Subcommittee on Annual Review 1999:836.
[97] Securities Exchange Act of 1934:section 21Db.
[98] Landau 1989:44.
[99] Miller and Jentz 1994:764 date the Williams Act to 1970.
[100] Hamilton 1998:990.
[101] Hutson 2000: 23; Miller and Jentz 1994:764.
[102] Hamilton 1998:990; Miller and Jentz 1994:764.

must be disclosed, including whether or not a tender offer is anticipated and whether or not a merger or consolidation is intended.[103]

The Williams Act introduced provisions that an offeror must afford to all shareholders the benefit of the highest price paid during the offer, during the offer. In addition, while that offer is active, no side purchases are allowed.[104] It is, however possible, for an offeror to effect a so-called two-tiered takeover by executing a tender offer and, thereafter, in the second step, merge the offeror and the offeree by acquiring the remaining shares on almost any terms.[105]

As nimble entrepreneurs develop methods to circumvent these provisions, the Securities and Exchange Commission promulgates regulations to eliminate those devices. The overall effect of these developments is a regulatory scheme of bewildering complexity.[106]

It is submitted that the broader principles of equality are contained in this legislation in respect of the price equality provisions. It does not, however, present any additional specific remedies for the protection of minority shareholders.

3.5 Freeze-outs: the risk run by minority shareholders

A freeze-out may be briefly described as a transaction in which the majority shareholders, as the shareholders in control of the company, eliminate the shareholding of the non-controlling shareholders.[107] Such an elimination of minority shareholders may be effected by forcing the minority shareholders to take cash in exchange for their shares or by compelling them to dissent and seek appraisal.[108] The term 'freeze-out' is accompanied by a related term: the 'squeeze-out'. The latter term refers to the use of illegal means to achieve the same end as the former.

The freeze-out, is, however, by no means regarded as a universal evil. Some authors have, in fact, put forward the following arguments in favour of control transactions that has the effect of ultimately eliminating minority shareholding:-

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[103] Brown 1999:136 – 137; Miller and Jentz 1994:764.
[104] Poser 1991:283.
[105] Poser 1991:283.
[106] Hamilton 1998:990.
[107] Miller and Jentz 1994:759.
[108] Schneeman 1997:370. See also Morello 1983:144.

a) by eliminating so-called free-riding shareholders in a freeze-out, the purchaser may be able to recoup the costs of an expensive takeover by appropriating the gains from the transfer of control;

b) a freeze-out increases expected aggregate shareholder' wealth if it increases the likelihood of a profitable transfer of control;

c) a freeze-out of minority shareholders in a long-standing subsidiary will produce profit if the combined entity is greater that the sum of the (former) parent and subsidiary;

d) moreover, a freeze-out is beneficial if it reduces the cost of policing conflict of interest between the parent and the subsidiary.

From this reasoning it has been deducted that the elimination of minority shareholders can increase the likelihood that profitable new ventures will be undertaken.[109]

Such reasoning results in the so-called 'proper business purpose' test. This test formed the first step in a court's review of the fairness of a transaction and whether or not the elimination of minority shareholding is to be sanctioned by the court.[110] This reasoning (and the quandary in which minority shareholders find themselves) is aggravated in leveraged buy-outs[111] where financial support for an acquisition is normally dependant upon the acquisition of a 100% stake in the target company.[112] This test has, however, been discarded by the Delaware Supreme Court.[113]

When the fiduciary duties between the majority shareholders and the minority shareholders[114] and the proper business purpose test are combined, the effect is that minority shareholders may be squeezed out of a company if the squeeze-out is not the sole aim of the transaction.[115]

The third test applied by the court in such contested transactions relates to the fairness of the transaction. In this context, fairness is determined with reference to a fair price and fair procedures employed by the board in reaching the decision to approve the transaction and adequate disclosure to outsiders regarding the transaction.[116]

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[109] Easterbrook and Fischel 1982:705 – 706.
[110] *Singer v Magnavox Co.* 380 A.2d 969 (Del. 1979). See also Morello 1983:150.
[111] A leveraged buy-out may be described as a transaction in which the purchaser finances his/her acquisition of the offeree through a loan secured with the assets of the target company bonded as collateral.
[112] Torres 1986:359.
[113] *Weinberger v UOP, Inc* 457 A.2d 701 (Del. 1983).
[114] See the discussion at 3.2 above.
[115] Torres 1986:364.

While federal legislation on the topic provides a measure of protection to minority shareholders, state law provides more effective mechanisms for the combating of freeze-outs.

3.6 A familiar test of fairness

Once it had been established that minority shareholders were frozen out of a corporation for a 'proper business purpose' and that the majority shareholders have not breached their fiduciary duty,[117] the minority shareholders are entitled to a judicial review of the fairness of the entire transaction.[118]

This test of fairness comprises two components, namely fair dealing and fair price.[119] The test for fair dealing relates to such factors as the disclosure of material information, the structure and negotiation of the transaction and the approval of the board of directors and the shareholders.[120] More specifically, the results of such a test will be condemning if the facts bring to light any breach of fiduciary duty.

The test for fair price, in turn, focuses on all the relevant economic and financial considerations.[121] Though the Delaware Block method, as described below was, specifically rejected,[122] the court did not include any consideration of the influence of the transaction itself on the fair price of shares.[123]

In Delaware it has been held that the appraisal remedy is an exclusive one. That means that it is now the only remedy available to shareholders objecting to a corporate combination in appraisal proceedings.[124] Allegations of unfair self-dealing or wrongdoing have to be asserted in a separate claim.[125] It has been held, however, that the 'fair price' test in a action based on the fairness of

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[116] *Weinberger v UOP, Inc* 457 A.2d 701 (Del. 1983):711. See also Morello 1983:149.
[117] In cases where such breach of fiduciary duty has been found, the court has granted such equitable relief as rescission of the transaction. Morello 1983:145.
[118] Torres 1986:365; Morello 1983:155.
[119] Coates 1999:1259; Torres 1986:369.
[120] Torres 1986:369; Morello 1983:156.
[121] Torres 1986:369.
[122] *Weinberger v UOP, Inc* 457 A.2d 701 (Del. 1983).
[123] Torres 1986:370.
[124] See the discussion in Wertheimer 1998:617 – 618 on the impact of the Delaware Supreme Court decision in *Weinberger v UOP, Inc* 457 A.2d 701 (Del. 1983). See also the discussion by Morello 1983:144 – 162 of the same judgment.
[125] Wertheimer 1998:687.

the transaction as a whole, will be substantially the same as a 'fair value' test conducted in appraisal proceedings.[126]

3.7 The shareholder's right of appraisal

The shareholders right of appraisal represents a general shareholder remedy that is indigenous to the field of corporate combinations.[127]

This notion stemmed from an era in which the corporation closely resembled the partnership and the courts fiercely protected the possession and accumulation of property in order to increase economic development. Due to the danger that a majority shareholder might act in a manner that reduced the value of that shareholding of the minority shareholder, the unanimous consent of all shareholders was required to effect a fundamental corporate action.[128] The power to manage a company was, in effect, derived from shareholders as quasi-partners in an incorporated partnership.[129]

3.7.1 Dissenters' and appraisal rights

Dissenters' rights developed from this notion that certain corporate structural changes must be assented to by all of the shareholders, or a significant majority of shareholders.[130]

> 'Dissenters' rights, or appraisal rights as they are sometimes called, is the phrase coined for less than unanimous merger approval, while still preventing shareholders with smaller ownership stakes from being taken advantage of or financially mistreated.'[131]

The right of shareholders to dissent to certain corporate combination transactions first appeared in the 1957 revision of the Model Business Corporations Act.[132] It was retained and extended in

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[126] Coates 1999:1261.
[127] It should be noted that the term 'appraisal provisions' in terms of the EU Merger Control Regulation refers to an assessment of whether or not a concentration as envisaged in Article 3 of the regulation exists. This is not to be confused with the appraisal procedures discussed here.
[128] King 1996:905; Anonymous 1976:1026 – 1027.
[129] King 1996:905.
[130] Wertheimer 1998a:662; 1998b:618 – 619; Thompson 1995:3; Siegel 1995:86; Reid 1994:516.
[131] Hollis 1999:139. It should be noted that dissenters' rights and appraisal rights are not the same rights. The rights to dissent on a proposal will lead to the right to seek appraisal by court of the fair value of shares held.
[132] Model Bus. Corp. Act Ann. § 73 ¶ 1.

subsequent revised acts, detailing the right of shareholders to dissent and the procedure to be followed.

The protection of shareholders is accomplished through so-called 'appraisal rights' which afford shareholders dissatisfied with an envisaged corporate combination, an opportunity to exchange his/her shareholding for cash at a price which is determined by a court to be fair.[133] This right developed as the right to effectively block a merger by dissention eroded in response to economic needs.[134] In addition, the courts have developed the 'de facto merger' doctrine under which the court treats a transaction which is not literally a merger as if it were one, if it is the functional equivalent of a merger. The most common result of such a construction would be that selling shareholders are awarded an appraisal right.[135]

The corporation is then responsible for purchasing the shareholding of the dissenting shareholder.[136] This right of appraisal is substantially afforded to shareholders in transactions that materially and adversely affect the rights of that shareholder.[137]

These rights are only available when granted by statute.[138] The Indiana Code[139] offers a good example of the typical provision made for dissenters' rights.[140] A dissenter is described as:

> 'a shareholder who is entitled to dissent from corporate action under section 8 of this chapter and who exercises that right when and in the manner required by sections 10 through 18 of this chapter.'[141]

Section 8, in turn, determines:-

> 'A shareholder is entitled to dissent from, and obtain payment of the fair value of the shareholder's shares in the event of, any of the following corporate actions:
> (1) consummation of a plan of merger to which the corporation is a party ...
> (2) consummation of a plan of share exchange to which the corporation is a party ...

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[133] Moll 2000:792 – 793; Hollis 1999:138; Schneeman 1997:380; Clarke 1986:443.
[134] Wertheimer 1998:614 - 615. See especially the discussion of Siegel 1995:93 – 94 on compensation for loss of veto as a purpose of the appraisal remedy. Reid 1994:516.
[135] Thompson 1995:32 – 35.
[136] Anonymous 1976:1023.
[137] Clarke 1986:443.
[138] Miller and Jentz 1994:754; Reid 1994:517.
[139] As amended through the 1999 regular session.
[140] Indiana Code IC 23-1-44: chapter 44.
[141] Indiana Code IC 23-1-44-2.

(3) consummation of a sale or exchange of all, or substantially all, of the property of the corporation other than in the usual or regular course of business, if the shareholder is entitled to vote on the sale or exchange other than in the usual or regular course of business ...'[142]

In this manner the exact situations in which a dissenter may institute action for fair price is determined. At the time at which the proposed transaction is announced, the company will normally notify those shareholders who have appraisal rights of those rights. The holder is then required to give notice to the company, prior to the vote taken by the shareholders on the issue, that he/she demands payment of the fair value of his/her shares. The holder must then refrain from voting in favour of the transaction. The holder is also required to deposit the relevant shares with the company.

This right is granted not only in takeover and merger situations, but also in transactions that constitute a substantial sale of assets, which adversely affect the rights of shareholders.[143]

Despite the importance of this shareholder remedy, no consensus exists between states on which transactions should trigger appraisal rights, which classes of shareholders should have these rights or what procedure should be used.[144]

3.7.2 Fair value

In determining the fair value of shares, the courts in the different states in America, have developed a number of divergent methods. One such method employed in a number of jurisdictions, is the Delaware Block method, even though this method has been abandoned in the state of Delaware.[145] Employing this method, the court does not take the relevant transaction into account and most courts do not take into account that the particular shares will not confer control of the company upon purchase.

The court then considers three factors in determining fair price, namely:-

a) the market price of the shares just prior to the transaction;

b) the net asset value of the company; and

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[142] Indiana Code IC 23-1-44-8.
[143] Clarke 1986:449.
[144] Siegel 1995:81.
[145] *Weinberger v UOP, Inc* 457 A.2d 701 (Del. 1983); Wertheimer 1998:617. See also the discussion by Morello 1983:158 – 162.

c) the earnings valuation of the company.[146]

Despite these guidelines, it is difficult to determine 'fair price' in this context exactly, especially when the corporation involved is a small one with no real market value in shares.[147] To this end, some courts have taken to affording the corporation a 'lack of marketability discount'.

Pursuant to the Delaware court's rejection of the Delaware block method, a number of other valuation methods evolved, the most prominent of which is the discounted cash flow method. The technique of valuation operates on the premise that the value of a company is determined by the present value of its future cash flow predictions.[148]

It is important to note that the fair price paid in consequence of the right of appraisal does not amount to a sharing of the premium paid for control in a corporate control transaction.[149] Shareholders receive the equivalent of what they gave up, as is evidenced from the factors taken into regard described above. The 1981 Delaware statute expressly provided that the court shall appraise shares, determining fair value exclusive of any element of value arising from the expectation.[150]

The proposals offered in the Model Business Corporation Act are less explicit, but the provision had substantially the same effect:

> '[f]air value of shares means that their value immediately before the effectuation of the corporate action to which the dissenter objects, excluding any appreciation or depreciation before in anticipation of such corporate action unless such exclusion would be inequitable.'[151]

Subsequent to the 1998 amendment proposal, the model provisions reflect an altered approach to the fair value of shares:

> '"Fair value" means the value of the corporation's shares determined:
> - Immediately before the effectuation of the corporate action to which the shareholder objects;

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[146] Wertheimer 1998:625; Torres 1986:368.
[147] Hollis 1999:138.
[148] Wertheimer 1998:627.
[149] Easterbrook and Fischel 1982:731. See also the discussion on *Bell v Kirby Lumber Corp* 413 A.2d 137 (Del. 1980) in Miller and Jentz 1994:759.
[150] Delaware Code 1981: Title 8, section 262 (h).

- Using customary and current valuation concepts and techniques generally employed for similar business in the context of the transaction requiring appraisal; and
- Without discounting for lack of marketability or minority status except, if appropriate, for amendments to the articles ...'[152]

Should the merger be approved, the company must issue the dissenting shareholders a notice detailing where their share certificates are to be lodged and from where to demand payment. The offeror company is then obliged to pay their own dissenting shareholders a fair consideration.[153]

3.7.3 Compulsory acquisition and the short form merger

Section 13.02(a)(1) of the Model Business Corporations Act also proposes a right of appraisal to the minority shareholders in a subsidiary company where the parent company already owns 90% of the shares in that subsidiary and is exercising its right under section 11.04 to acquire the remaining shareholding without the consent of the subsidiary's shareholders.[154] This corresponds closely with the powers of compulsory acquisition that features so prominently in South Africa, British and Australian company law.[155]

Where the short form merger does not require the consent of the shareholders of the offeree company, it follows that they are afforded no dissenter's or appraisal rights. The fiduciary duty owed by the majority shareholders to the minority shareholders in other mergers are,[156] however, still in effect here.

When that application is coupled with the 'proper business purpose test',[157] a short form merger will be sanctioned if it is conducted by the majority shareholders solely for the purpose of eliminating minority shareholding.[158]

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[151] Model Business Corporation Act: section 81(a)(3).
[152] Model Business Corporation Act (suggested amendments): section 13.01(4).
[153] Clarke 1986:451.
[154] Clarke 1984:450; See also the discussion on so-called 'short form mergers' above. These proposed provisions were amended by the American Bar Association in 1998 resulting in the recommended provisions in the former section 11.04 now being contained in section 11.05.
[155] Poser 1991:279.
[156] See the discussion at 6.2 above.
[157] See the discussion on freeze-outs and 'squeeze-outs' at 3.5 above.
[158] Torres 1986:365.

3.7.4 A satisfactory dispensation?

One of the main arguments put forward in favour of these kinds of rights is that it significantly decreases the risk of unfair treatment in major corporate control transactions,[159] especially where majority shareholders are concerned. Appraisal rights are widely viewed as serving a minority shareholder protection role.[160]

The exceptions to this rule also provide valuable insight as to the object of the right:-

a) the right is not afforded shareholders in instances where the sale of the assets is for cash and the net proceeds are to be distributed among the shareholders of the company;

b) the right is not available in instances where the vote of the remaining members of a surviving company pursuant to a merger is not required to authorise the merger; and

c) the right is not afforded to shareholders in a short form merger where the parent of the subsidiary to be merged with already owns 90% of the shares.[161]

Though the procedure to be followed forms a logical and coherent framework within which the dissenting shareholders have the opportunity to exercise their rights, it reflects closely its origins in the law of partnership. It is intrinsically linked to the right of the shareholder to participate in the management of the corporation and does not aim to protect shareholders in the target company.

This right of appraisal differs considerably from the construction in the British derivative systems in that the dissenting shareholders of the offeror company are given the opportunity to opt out, as opposed to the dissenting shareholders of the target company.

The aim of appraisal rights have also undergone a significant shift. Where the aim may have originally been to compensate shareholders for the loss of their right to veto corporate combinations in order to facilitate economic development, it is now more commonly employed as a cash-out mechanism in mergers.[162]

The so-called 'stock market exception' to these rights have caused significant dissatisfaction among those shareholders whose stock is publicly traded and who were not afforded the normal

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[159] Clarke 1986:444.
[160] Wertheimer 1998:616.
[161] Clarke 1986:450.
[162] Wertheimer 1998:615; Thompson 1995:11 – 27.

right of dissention. By 1976, some twenty states had withdrawn the dissenter's rights with respect to such shareholders. They were, instead, expected to sell their shares on the market.[163]

3.8 Internal arrangements aimed at the protection of shareholders

While state law makes provision for the protection of minority shareholders, shareholders in the United States have formulated innovative measures for the protection of minority shareholders in their constitutive documents. Some authors have even commented on the trend:-

> 'The 1990s have been a decade of shareholder activism. As the decade has unfolded, shareholders have increasingly turned to the use of shareholders proposals focusing on issues of corporate governance.'[164]

It has become practice in certain jurisdictions in the United States to amend the certificate of incorporation of a company to incorporate certain safeguards aimed at preventing the possible consequences of a two-tiered bid as described above.[165] One such consequence is that an offeror who has successfully completed the first stage of such a bid can acquire the shareholding of the remaining stockholders at a considerable discount.[166]

To combat these dangers, shareholders have inserted provisions relating to supermajority voting requirements, fair price requirements, or mandatory bids in their internal documents.[167]

3.8.1 Supermajority voting requirements

Provisions formulated as amendments to the certificate of incorporation may take the form of supermajority voting requirements and mandatory redemption provisions.[168] These provisions are by no means statutory or regulatory safeguards for the protection of minority shareholders. They are rather the act of majority shareholders aimed at ensuring some measure of protection for

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[163] Anonymous 1976:1024 – 1025. In the same manner, the 1998 proposed amendments to the Model Business Corporations Act exclude shares traded on the New York Stock Exchange or the American Stock Exchange in the amended suggested section 13.02(b)(1)(i). See also Balotti and Finkelstein 2000: IX – 147; Thompson 1995:29 – 31; Bartlett 1991:257.
[164] Hurwitz 1999:607
[165] Finkelstein 1984:294.
[166] Finkelstein 1984:292.
[167] See also Brown 1999:135.
[168] Finkelstein 1984:294.

themselves, should they be forced into the position of minority shareholders pursuant to the successful completion of the first stage of a two-tiered bid.

The basis of such provisions are, however, not fiduciary in nature. It is, instead, contractual in nature due to the fact that the certificate of incorporation of a company constitutes a contract between the shareholders of the company.[169] Though it may well be argued that these contractual rights cannot be enforced as an obligation against a third party, analogous situations in American law have been effectively utilised to do so.[170]

Supermajority voting requirements present a departure from the general principle of corporate democracy in which one share will empower the holder thereof to exercise one vote.[171] Voting rights flow from the notion that the company is in effect an incorporated partnership and that the members and entitled to participate in its management and that the inherent rights of ownership require the assent of each shareholder whenever new corporate combinations are envisaged.[172]

Such an interpretation would mean that the same kind of compromise represented in dissenters' rights also feature in the concept of supermajority voting as a reversion to unanimous consent.

3.8.2 Fair price requirements

The fair price requirement has been called the more popular cousin of the supermajority voting requirement, when viewed as defense mechanisms to takeovers.[173]

Though significant variations in fair price requirements feature, the general requirement is that the consideration offered be the same as that offered in the first stage of the bid. Another common feature is that minority shareholders be offered the highest consideration paid to shareholders during the first stage of the bid.[174]

The consideration to be paid is calculated by normally guaranteeing the same premium to be paid above and beyond the market value of the shares acquired. This means that the exact consideration paid may be varied if the market price of the shares have changed.[175]

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[169] Finkelstein 1984:301.
[170] Finkelstein 1984:302.
[171] King 1996:896.
[172] King 1996: 913 – 914.
[173] King 1996:918.
[174] Finkelstein 1984:296.
[175] Finkelstein 1984:296.

Most such provisions make provision for exceptions to the requirement in instances where the majority of the minority shareholders approves the bid.[176] Such minority shareholders are also referred to as the disinterested majority, a concept familiar to South Africa law.[177] Typical provisions may be triggered by a required shareholding at a level below majority ownership. Frequently, beneficial ownership is also taken into consideration in the calculation of the required level of shareholding.[178]

Ironically, supermajority voting requirements in the arena of takeovers and mergers have been criticized as a mechanism aimed at the entrenchment of the existing majority through the deterrent effect on offerors.[179]

Though fair price requirements may be set separately from mandatory bid requirements, they may be incorporated into the mandatory bid requirements, if any. It should, however be noted that fair price considerations are only that – no across-the-board-offer is required. These measures are merely aimed at ensuring that when shares are purchased from the remaining shareholders, those shares are not acquired at a significant discount.

3.8.3 Mandatory bid amendments

Mandatory bid amendments are generally closely modeled on the provisions of the City Code on Takeovers and Mergers, but by no means provide an assurance of the equal treatment of shareholders in an acquisition.[180]

The mandatory bid generally provides that once a threshold percentage holding in the offeree company has been accumulated by any entity or group of affiliates, that entity or group must make an offer for the remaining stock of the corporation.[181] Normally, the required consideration for such an offer will be equal to the highest consideration paid during the original tender offer. Frequently, it is also required that such consideration be paid in cash.[182]

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[176] Finkelstein 1984:298.
[177] See the discussion at 7.4.4.6.
[178] Finkelstein 1984:296.
[179] King 1996:919.
[180] Finkelstein 1984:295.
[181] Finkelstein 1984:298.
[182] Finkelstein 1984:298.

As is the case with fair price requirements, the majority of minority shareholders may waive the requirements set in this manner.[183] This use of supermajority voting as a means of approving both fair price requirements and the mandatory bid requirements have been utilised to enforce the provisions where enabling statutes make provision only for supermajority voting amendments to the company's certificate of incorporation.[184]

3.8.4 Shareholder by-laws of the invalid kind

More recently, shareholders have taken to enacting shareholder by-laws that seek to curb the power of the board of directors to take certain decisions regarding the acceptance of tender offers.

Most noticeably, such by-laws contain provisions that allow the board of directors to withdraw a 'poison pill'[185] only at the end of an extended period of time, save with the express consent of the shareholders of the company and only if the general price offered is at least 25% higher than the applicable closing price on the stock exchange.

It has been submitted that such a by-law undermines the primary management task of the board of directors and will not be upheld when tested to state law.[186]

3.9 Other measures aimed at the protection of shareholders generally

As is the case in other jurisdictions, there are also other provisions aimed at the protection of minority shareholders. These provisions relate mainly to the right to inspect the documents of the company and the capacity to participate in the management of the company.

3.9.1 Shareholders' inspection rights

The Revised Model Business Corporations Act affords shareholders an unrestricted right to inspect certain corporate records. These records include:-

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[183] Finkelstein 1984:299.
[184] Finkelstein 1984:304.
[185] The term 'poison pill' in such a by-law will normally refer to a rights plan aimed at discouraging any potential offeror from consummating a merger by making the offeree less attractive.
[186] Hurwitz 1999:634 – 635.

a) the articles of incorporation;
b) by-laws;
c) board resolutions creating classes of stock;
d) the minutes of shareholders meetings;
e) annual reports, and the like.

These records must be kept at the corporation's main place of business for inspection by any shareholder.[187]

3.9.2 Shareholder proposals in proxy materials

Due to the fact that very few shareholders attend meetings of shareholders in person, the proxy mechanism has developed to render corporate decision-making more effective.

In the United States, corporations are required to send its shareholders all proposals to be considered at a meeting when they supply them with proxy materials.[188] The purpose of this requirement is to afford shareholders an opportunity to participate on an informed level in decisions which may substantially affect the value and/or returns on their investment.[189]

In addition, shareholders who hold in excess of $ 1 000.00 of stock in a corporation may submit proposals for inclusion in corporate proxy material.[190]

3.10 Conclusion

Though the law in the United States developed from a period in which those states were the North American colonies of the United Kingdom,[191] it is evident at first glance that the development has taken a direction entirely different from that in the United Kingdom and countries with British-derivative company law systems. Despite this, some of the effects achieved in the protection of minority shareholders are curiously alike.

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[187] Miller and Jentz 1994:751.
[188] Securities and Exchange Commission Rule 14a-18.
[189] Miller and Jebtz 1994:753.
[190] Securities and Exchange Commission Rule 14a-8.
[191] King 1996:900.

The shareholder's right of appraisal as a primary remedy echoes some of the notions examined in the previous chapter. It is, however, submitted that the real question in this regard relates to whether or not the shareholders protected by it are indeed in need of protection. In the jurisdictions that will be examined in the next four chapters, the shareholders of the offeror are not seen as so vulnerable as to merit protection.

The other tests applied by the courts in the protection of minority shareholders appear to be of far more importance in the context of this study. The application of the proper business purpose test presents sound justification for remedies and actions that may appear gratuitous and unnecessary in the context of takeovers and mergers. This test, now discarded in Delaware,[192] coupled with the investigation into the majority shareholders' exercise of their fiduciary duty where applicable, presents a fairly effective screening test prior to the broader test that relates to the fairness of the transaction as a whole. Both components of this test as they relate to fair price and fair dealing present justifiable shareholder protection mechanisms. The test is, however, still applied in other jurisdiction in the United States.[193]

This protective system will subsequently be compared with protective mechanisms in other jurisdictions and ultimately with those protective mechanisms in our own.

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[192] *Weinberger v UOP, Inc* 457 A.2d 701 (Del. 1983).

[193] See the comment of Moll 2000:750 – 751 that US law also contains the doctrine of shareholder oppression, which protects the minority stockholders from the improper exercise of majority control. Such action may be imputed if, for instance, conduct with detrimental effect on minority shareholders is not justifiable with a proper business purpose.

CHAPTER 4

THE LAW IN THE UNITED KINGDOM

4.1 Introduction

As is the case in every other jurisdiction, minority shareholders in the United Kingdom are at the mercy of the majority shareholders in any company:-

> 'Minority members must, in principle, accept the decisions of the majority and must also acknowledge that the power lawfully enjoyed by their more numerous brethren is a fact of business life.'[1]

Shareholders in the United Kingdom enjoy protection in terms of both common law and statutory measures and[2] both types of measures will be reviewed in order to place minority shareholder protection in takeovers in its broader context. The protection of shareholders in the United Kingdom Companies Act of 1985 is primarily aimed at the protection of the identical rights and interests of all shareholders or the rights and interests of a particular class of shareholders.[3] Despite this, the law in the United Kingdom contains very few special rules for takeovers.[4]

The primary instrument aimed at the regulation of takeovers and mergers, the City Code on Takeovers and Mergers (the City Code) will be analysed in as far as it has bearing on the protection of minority shareholders. This Code is of unique importance due to the fact that it forms the basis of the South African Securities Regulation Code on Takeovers and Mergers. In this analysis, the mandatory bid as it is found in the City Code, coupled with the compulsory acquisition procedure as it appears in the United Kingdom, will form the main focus.

In this study of the relevant provisions it is also necessary to consider the impact of the new regime introduced by the Financial Services and Markets Act 2000 on a regulatory system that has hitherto been hailed as a very effective one.[5]

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[1] Sealy 1989:443.
[2] Hollington 1994:1 – 2; Hollington 1999:1 – 3.
[3] Pennington 1990:32.
[4] Morse 1995:820; Sealy 1989:506.
[5] Haines 2000:1.

4.2 Minority shareholder protection

When a shareholder is dissatisfied with the company's governance, one of the easiest and best options may be to simply withdraw their investment from the company by selling their shares.[6]

Should the shareholder, however, elect to remain a member of the company and oppose the particular situation in a court of law, he/she may proceed in one of three ways. He/she may institute a derivative action in respect of a wrong done against the company, or a representative action on behalf of a group of shareholders whose similar rights have been infringed upon. It is also possible to institute a personal action where an individual right has been infringed.[7]

A fair number of so-called minority shareholder rights exist in company law in the United Kingdom. Section 5 of the 1985 Companies Act affords holders of 15% of the issued capital of a company to apply to the court for cancellation or alteration of the objects of a company and empowers the court to make such an order as it thinks fit,[8] while section 17 empower holders of 15% of the issued capital or any class thereof to apply to the court for the alteration or cancellation of conditions in the memorandum which could have been contained in the articles.[9]

Section 127 allows the holders of 15% of the issued shares of the relevant class to apply to for the cancellation of a variation of class rights where either the memorandum or articles provide for such variations subject to the consent of that class, or the class rights are not contained in the memorandum and no provision is made in the articles for the variation of such rights.[10] In turn, section 376 allows either 5% or 100 of the shareholders of a company to requisition the circulation of resolutions and notices.[11]

Section 368 allows holders of 10% of the paid up capital of a company to requisition the holding of an extraordinary general meeting,[12] while section 373 allows five members with the right to vote in the relevant meeting, members representing 10% of the total voting rights of all members having the right to vote at that meeting or members in possession of 10% of the

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[6] Farrar & Hannigan 1998:429.
[7] Farrar & Hannigan 1998:430.
[8] Barc 1997:S40/58 – S40/61; Shepherd 1995:250; Xuereb 1989:36.
[9] Barc 1997:S40/58 – S40/61; Hollington 1994:119 – 121; Xuereb 1989:36.
[10] Barc 1997:S40/58 – S40/61; Shepherd 1995:250; Hollington 1994:121 – 123; Xuereb 1989:36.
[11] Xuereb 1989:35.
[12] Xuereb 1989:35.

paid-up shares which confer the right to vote, to demand a poll at any general meeting on any question other than the election of a chairperson.[13]

Section 431 confers the right on either 200 members or members holding one-tenth of the shares to apply to the Department of Trade and Industry for the appointment of an inspector or inspectors to investigate the affairs of the company[14] while section 442 enables the same persons to apply to the Department of Trade and Industry for the appointment of inspectors to investigate the membership of a company.[15]

Section 214 permits the holders of 10% of the paid up capital carrying voting rights to requisition the company to exercise its powers under section 212 to require information with respect to interests in voting shares.[16] In addition, section 54 enables either the holders of 5% of the nominal value of the shares in the company or 50 of the members of the company to apply to the court for the cancellation of a special resolution[17] and section 157 empowers the holders of 10% of the company's issued shares to apply to the court for the cancellation of a special resolution by a private company approving financial assistance for the purchase of shares.[18]

Section 176 of the Act gives any member of the company and any creditor of the company the right to apply to the court for the cancellation of a special resolution approving any payment out of capital for the redemption or purchase by a private company of its own shares.[19]

These rights are primarily aimed at the provision of access to a competent forum in which an impartial decision can be obtained on the disputed measure.[20]

In addition, it would be possible for any shareholder, and not just a minority shareholder, to bring rogue directors to book through one of the following mechanisms:-

a) the voting power of the shareholders;[21]

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[13] Xuereb 1989:35.

[14] The Department of Trade and Industry is afforded the discretion to appoint an inspector or refuse the appointment of an inspector. The provision of security for costs may also be required. Barc 1997:S40/58 – S40/61; Hollington 1994:125 – 126; Xuereb 1989:36.

[15] In this instance the Department of Trade and Industry must appoint an inspector, save in instances where it is of the opinion that the application is vexatious. If this is not the case, all matters alleged must be investigated; Xuereb 1989:37.

[16] Xuereb 1989:37.

[17] Barc 1997:S40/58 – S40/61; Shepherd 1995:250; Xuereb 1989:37.

[18] Barc 1997:S40/58 – S40/61; Shepherd 1995:250; Xuereb 1989:37 – 38.

[19] Barc 1997:S40/58 – S40/61; Shepherd 1995:250; Xuereb 1989:34.

[20] Xuereb 1989:38.

[21] See however the critique of Miles and Proctor 2000:142 – 144 in which the average individual shareholder in a large public company is described in the following terms: 'He views the company as a means of making money. He invests in the company, not primarily because

b) the institution of criminal proceedings where applicable;

c) administrative controls; or

d) legal actions by shareholders.[22]

A review of minority shareholder protection in the United Kingdom also has to be conducted against the backdrop of the Law Commission's proposals for the reform of shareholder remedies.

A consultation paper[23] on the topic was circulated in October 1996.[24] This consultation paper was based on a brief for the revision of the exceptions to the rule in *Foss v Harbottle*[25], other measures aimed at the protection of shareholders and shareholder remedies.[26]

A final report was published in October 1997.[27] It was concluded that the rule in *Foss v Harbottle* was complicated and unwieldy, with much of it derived from precedent.[28] In addition, it was found that the scope of the exceptions to the rule was uncertain and that the procedural obstacle posed by the rule was such that merely establishing *locus standi* to bring action was a mini-trial in itself. As a consequence, it was recommended that a new statutory derivative action be introduced.[29]

It is evident from the Law Commission's statements on the subject, that it is conscious of the need to enable the company to function effectively on a day-to-day basis without the interference of shareholder challenges. Likewise, it is sensitive to the importance of balancing that need with the protection of minority shareholders and the enhancement of shareholder confidence through the provisions of adequate mechanisms for redress.[30]

The Department of Trade and Industry has also released a consultation document styled 'Modern company law for a competitive economy: developing the framework.' A number of proposals are made on key areas in corporate governance and one of the main focus areas of these proposals relate to a reform of the remedies available to minority shareholders.[31]

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he is emphatic with the long-term goals of the company or enthusiastic about its business operations, but because he is interested in the award of dividends at the end of the year.'

[22] Schreiner 1979:206 – 212.

[23] Law Commission Consultation Paper No 142.

[24] Farrar & Hannigan 1998:440; Faber 1996:119.

[25] [1843] 2 Hare 461.

[26] Farrar & Hannigan 1998:440; Faber 1996:119.

[27] Law Commission *Shareholder Remedies* No 246 (CM 3769).

[28] Arora 2000:37; Roberts & Poole 1999:38.

[29] Farrar & Hannigan 1998:440. See also the discussion on the proposed statutory derivative action at 4.2.4 below.

[30] Poole and Roberts 1999:101.

[31] Ramsay 2000.

4.2.1 The rule in *Foss v Harbottle*

The rule in *Foss v Harbottle* as discussed above[32] developed in English jurisprudence and was received from there into the different English law derivative systems. As imparted above, this rule entails the right of the majority to bar minority action through the ratification of a wrong to the company and the company's virtually exclusive right to bring action in instances where its rights have been infringed upon.[33] Though, in principle, all shareholders are entitled to the same rights, rendering the term minority shareholders' rights a virtual misnomer, the rule in *Foss v Harbottle* forms a procedural obstacle to the enforcement of those rights.[34]

This rule does not apply in instances where the act complained of:-

a) is illegal;

b) is *ultra vires*;[35]

c) constitutes fraud on the minority[36] through:-

   i) expropriations of the company's property;[37]

   ii) breaches of the director's duties of subjective good faith; or

   iii) voting for company resolutions that are not bona fide in the best interests of the company;[38]

   and the wrongdoers are in control of the company;[39]

d) the act can be sanctioned only be means of a special resolution and that requirement is not satisfied;[40]

e) infringes the personal rights of an individual shareholder;[41]

f) justifies an exception whenever the justice of the case requires it; or

g) is subject to section 459 and 461(2)(c) of the Companies Act 1985.[42]

In these instances which qualify as exceptions to the rule in *Foss v Harbottle*, a derivative action may be instituted by the aggrieved shareholders.[43]

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[32] See 2.2.1 above.
[33] Morse 1999:302; Mayson, French & Ryan 1999:575; Morse 1995:398; Xuereb 1989:164 – 165; Boyle and Sykes 1986:28.001.
[34] Barc 1997:S40/21.
[35] Though the law relating to *ultra vires* action has been reformed in the United Kingdom, the exception remains as to action which would have been *ultra vires*, had it not been for the for the new provisions. Mayson, French & Ryan 1999:595 – 596; Goldberg 1999:224 – 226; Farrar & Hannigan 1998:433; Xuereb 1989:167 – 168.
[36] Fraud on the minority may be found in such instances as the expropriation of the company's property, certain breaches of directors' duties, instances where the majority does not its powers bona fide for the benefit of the company as a whole. Mayson, French & Ryan 1999:599; Goldberg 1999:227 – 228.
[37] See Farrar & Hannigan 1998:436 – 437.
[38] Xuereb 1989:169 – 172; Schreiner 1979:212.
[39] Boyle and Sykes 1986:28.002.
[40] Mayson, French & Ryan 1999:599; Goldberg 1999:227; Xuereb 1989:168 – 169;
[41] Mayson, French & Ryan 1999:599; Goldberg 1999:224, 227; Xuereb 1989:166.
[42] Barc 1997:S40/24.

Another exception exists as to instances in which the conduct of the majority is regular in form but unfair and oppressive as against the minority, though this too has been viewed as a form of fraud on the minority.[44] This exception arises from the obligation that rests on the majority shareholders to act bona fide in the interests of the company as a whole.[45]

Of course the personal right of a shareholder to institute action is recognised in such instances as the infringement of his/her personal rights.[46]

4.2.2 The derivative action

The derivative action[47] is in essence an action brought in the name of a plaintiff shareholder on behalf of the company in respect of a wrong against the company.[48] The action may be brought by any registered shareholder of the company at the time of bringing the action, even if that person was not a shareholder at the time of the wrong which forms the subject of the action.[49]

The derivative action may be brought in those instances that qualify as exceptions to the rule in *Foss v Harbottle* as described above, most notably in respect of fraud on the minority.[50]

It must be proven that the wrongdoers are in control of the company, normally by the presentation of evidence that both the directors and the general meeting have been called on to institute proceedings, have refused to do so and that such a refusal was brought about by the voting of the wrongdoers.[51]

The law governing this action has, however been deemed complex and obscure.[52] Shareholders have, for instance, faced a number of expensive and complex procedural hurdles in bringing the action.[53] There are, however, some major obstacles to the use of the

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[43] Morse 1995:400. It has also been submitted that the personal action is employed for actions illegal, ultra vires or approved by an inferior majority and derivative actions in the case of fraud on the minority. See Farrar 1998:433 – 436.
[44] Barc 1997:S40/28.
[45] Boyle and Sykes 1986:28.002.
[46] Shepherd 1995:247; Boyle and Sykes 1986:28.003.
[47] Pursuant to the promulgation of the 1998 Civil Procedure Rules, derivative actions are termed derivative claims and are described as claims by one or more of the shareholders in a company where the cause of action is vested in the company and relief is accordingly sought on its behalf. See also Mayson, French & Ryan 1999:581.
[48] Farrar & Hannigan 1998:435.
[49] Barc 1997:S40/35; Schreiner 1979:213.
[50] Farrar & Hannigan 1998:435.
[51] Schreiner 1979:213.
[52] Poole and Roberts 1999:99.
[53] Barc 1997:S40/37.

derivative suit. The procedure makes no special provision for the fact that the defendants effectively control all the information required by the plaintiff to make his/her case. In addition, the company is joined as a defendant and is therefor not on the natural side of the action. Costs was also once of the most problematic aspects of the action.[54]

Company law in the United Kingdom does, however, make provision for the indemnification of a minority shareholder who brings a derivative action provided the shareholder acts in good faith and reasonably in bringing the action.[55]

A court may order the payment of damages pursuant to a successful derivative action or direct that a receiver be appointed to take control of the company and possibly investigate the affairs of the company.[56]

The Law Commission has included as its first and second guiding principles respectively the familiar proper plaintiff and internal management rules. In this manner, the rule in *Foss v Harbottle* is eminently maintained.[57]

4.2.3 Unfairly prejudicial conduct

Provision was made in section 210 of the 1948 Companies Act for a specific form of minority shareholder protection. The action was designed as an alternative to the drastic step of having the company wound up on the grounds that it is just and equitable to do so.[58] The Jenkins Committee recommended a number of amendments to this provision.

Firstly, it was recommended that the remedy should be made available independent of whether or not the circumstances would justify the winding-up of the company on the grounds that it is just and equitable and that the remedy should cover both single occurrences and a course of conduct.

It was also recommended that the court be empowered to grant the remedy in both instances where it is required to prevent the commission of such conduct or halt the continuance of such action.

In addition, it was recommended that the scope of the action should be widened from instances of oppressive conduct to unfairly prejudicial or oppressive conduct and that both

[54] Schreiner 1979:215.
[55] Boyle and Sykes 1986:28.012.
[56] Barc 1997:S40/37.
[57] Poole and Roberts 1999:101.
[58] Sealy 1989:487; Morse 1999:321.

personal representatives and trustees in bankruptcy should be enabled to bring the action on shares transferred to them. Finally, it was recommended that the court should be explicitly empowered to order that action be brought by the company against third parties.[59]

This remedy was contained in section 75 of the 1980 Act[60] and the protection of minority shareholders has been significantly enhanced by the action provided for in section 459[61] in relation to unfairly prejudicial conduct.[62]

The court may make an order it thinks fit in circumstances where a member bringing an action under this section can show that:-

> 'the company's affairs are being or have been conducted in a manner which is unfairly prejudicial to the interests of its members generally or of some part of its members (including at least himself) or that any actual or proposed act or omission of the company (including an act or omission on its behalf) is or would be so prejudicial.'[63]

There are no limits on the court's discretion to grant relief in this respect, but four remedies are suggested in section 461(2):-

a) an order regulating the future conduct of the affairs of the company;
b) an order directing the company to refrain from certain actions;
c) an order authorising civil proceedings to be brought on behalf of the company; or
d) an order providing for the purchase of the shares of any member of the company by other members or by the company itself.[64]

South African law on this remedy developed in pursuance of the developments in English law and, as has been mentioned, the term 'oppressiveness' as contained in the original wording was altered on recommendation of the Jenkins Commission.[65]

The new term is designed to cover conduct falling short of illegality but representative of a visible departure from the standards of fair dealing.[66]

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[59] Schreiner 1979:219.
[60] Mayson, French & Ryan 1999:604. See also Arora 2000:37.
[61] Companies Act 1985.
[62] Poole and Roberts 1999:99.
[63] Companies Act 1985:s 459, See also Mayson, French & Ryan 1999:603; Farrar & Hannigan 1998:448; Morse 1995:417 – 423.
[64] Farrar & Hannigan 1998:455; Xuereb 1989:180.
[65] See 2.1.6 above.
[66] Barc 1997:S40/45.

4.2.4 The proposed statutory derivative action

Though it was recommended by the Law Commission that the proposed statutory derivative action replace the fraud on the minority exception to the rule in *Foss v Harbottle*, it would not affect the position explained above relating to personal actions.[67] The proposed statutory derivative action is confined to directors[68] in instances where the cause of action arises as a result of acts (or omissions) involving either negligence, default, breach of trust or duty, or a director putting him/herself in a position where his/her personal interests conflict with duties towards the company.[69]

The action may only be brought after 28 days' notice has been given of the proceedings to the company and in considering whether or not to grant leave, the court will take into consideration whether or not the applicant in acting in good faith and whether or not the proceedings are in the best interests of the company. In addition, the court will consider whether the wrong has been approved by the company in general meeting or whether the company has resolved not to pursue the cause of action. Finally, the availability of alternative remedies will also be considered.[70]

4.2.5 Conclusion

It is submitted that the traditional remedies and protective rights outlined above do not extend adequately into the unique arena of takeovers and mergers, an area that has been described as

> 'a specific area ... which marks the interface of corporate law and securities regulation.'[71]

While the underlying philosophy that the minority shareholder is bound to the decisions of the majority where that conduct is not unlawful or unfairly prejudicial may not be faulted, it is submitted that there are special factors at play in transaction that have the effect of a shift in the control of a company.

This arena is governed, in the United Kingdom, primarily by the provisions of the City Code on Takeovers and Mergers to the extent that a non-statutory Code is capable of such regulation.[72]

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[67] Farrar & Hannigan 1998:440.
[68] Poole and Roberts 1999:102.
[69] Farrar & Hannigan 1999:440.
[70] Farrar & Hannigan 1998:440 – 441.
[71] Farra 1993:6.

4.3 The City Code on Takeovers and Mergers

Not only the South African Securities Regulation Code on Takeovers and Mergers, but also, to a large extent, the proposed Thirteenth Directive, is based on the City Code on takeovers and Mergers.

4.3.1 Introduction

In 1959 the Governor of the Bank of England set up a working group to prepare a City Code on Takeovers and Mergers. This group was called the City Working Party and was, subsequent to the initial convention, reconvened in 1967.[73] On 27 March 1968 they produced the first City Code on Takeovers and Mergers.[74]

The City Code on Takeovers and Mergers is now issued by the Panel on Takeover and Mergers and operates

> 'principally to ensure fair and equal treatment of all shareholders in relation to takeovers. The Code also provides an orderly framework within which takeovers are conducted.'[75]

This Code represents the collective opinion of those persons who are professionally involved in the field of takeovers as to good business standards and ways in which fairness towards shareholders could be achieved,[76] and is accompanied by the Rules Governing the Substantial Acquisition of Shares.[77]

Applicability of the Code depends on the presence the following prerequisites: the companies must be either listed or unlisted public companies or a certain type of private company, which have had their equity share capital listed on the Stock Exchange during the past ten years, regularly published information relating to dealings in their shares, subjected their equity share capital to a prescribed statutory marketing arrangement and have filed a prospectus for

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[72] See, however, the discussion by Goldenberg 2000:25 – 27 on the specific effects of the Human Rights Act 1998 on the Panel and its activities.
[73] Johnstone 1980:37.
[74] Begg 1999:2.8; Farrar 1998:590; Johnstone 1980:38; Van Wyk de Vries Commission Supplementary Report 1972: par 70.02.
[75] City Code on Takeovers and Mergers:Introduction.
[76] City Code on Takeovers and Mergers:Introduction.
[77] Goldberg 1999:275; Farrar 1998:613. These rules seek to regulate the building of stakes in a company by regulating the speed of acquisitions.

the issue of share capital.[78] In addition, the companies must be resident[79] in either the United Kingdom, the Channel Islands or the Isle of Man.[80]

The City Code on Takeovers and Mergers[81] has no statutory base[82] and enforcement of its provisions is only indirectly possible by means of the Financial Services Act[83] *via* the provisions in the FSA's[84] Conduct of Business Rules that compels authorised persons to observe the Code.[85]

4.3.2 The new financial services dispensation

The Financial Services and Markets Act is the culmination of a radical reform programme announced in 1997.[86] The new Financial Services Authority (FSA) established in terms of the act combines the regulation of banking, securities and insurance business and replaces nine existing regulatory bodies.[87] The FSA is also granted radical new powers of enforcement among which the ability to seek civil penalties in the form of fines against individuals who breach its Code of Market Conduct through insider dealing or market manipulation.[88]

This approach represents a substantial departure from past City regulation. It has, in fact been hailed as an end to all self-regulation. [89]Though the act received royal assent on 14 June 2000, it will not come into full operation before 2001.[90] Due to the absence of clear alternative guidelines at the time of the completion of this study, the provisions of the City Code will be studied.

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[78] Davies 1997:778 – 779; Knight 1989:2 – 3; Creamer et al 1987:111 – 112.
[79] In order to be resident in the manner required, the company must be incorporated in one of the jurisdictions and have its place of central management in the United Kingdom, the Channel Islands or the Isle of Man.
[80] City Code on Takeovers and Mergers:Introduction; Morse 1999:605; Brown 1999:51; Poser 1991:260.
[81] The South African Securities Regulation Code on Takeovers and Mergers is closely modeled on the City Code, a fact that is stated in the explanatory notes to the Code. See also Mayson, French & Ryan 1999:247.
[82] Brown 1999:50; Farrar 1998:591; Lee 1993:192; Green 1992:12086; Murphy 1992:4; Xuereb 1989:206; Du Plessis 1988:25; Creamer at al 1987:111.
[83] Financial Services Act 1986.
[84] Formerly the SIB, or Securities Investment Board.
[85] Begg 1999:2.9; Mayson, French & Ryan 1999:247; Farrar 1998:593 – 594; Andenas 1996:151.
[86] Ryder 2000:62; Taylor 2000:3.
[87] In this manner, for instance, the FSA will assume the regulatory functions of the Insurance Directorate of the Treasury, the Building Societies Commission, the Friendly Societies Commission and the Registry of Friendly societies. Ryder 2000:62; Bagge 1998:194.
[88] Taylor 2000:3.
[89] Taylor 2000:5.
[90] Haines 2000:1.

4.3.3 General principles

The City Code on Takeovers and Mergers is based on a number of general principles. These principles are put forward as principles of good standards of commercial behaviour.[91] The following of these principles relate to the principle of equal opportunity and the protection of minority shareholders:-

a) All shareholders of the same class of an offeree company must be treated similarly by an offeror;[92]

b) No information may be made available by either the offeror or the offeree which is not made available to all shareholders;[93]

c) Rights of control must be exercised in good faith and the oppression of a minority is wholly unacceptable;[94]

d) Where control of a company is acquired by a person, or persons acting in concert, a general offer to all other shareholders is normally required; a similar obligation may arise if control is consolidated. Where an acquisition is contemplated as a result of which a person may incur such an obligation, he must, before making the acquisition, ensure that he can and will continue to be able to implement such an offer.[95]

Control is, in turn, defined as follows:-

> 'control means a holding, or aggregate holdings, of shares carrying 30 per cent or more of the voting rights ... of a company, irrespective of whether the holding or holdings gives de facto control.'[96]

These general principles find application in a number of the provisions of this Code. Of primary importance to this study, however, is the employment of those principles in the mandatory bid.

4.3.4 The mandatory bid

4.3.4.1 Introduction

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[91] City Code on Takeovers and Mergers:Introduction; Poser 1991:261; Xuereb 1989:208; Creamer et al 1987:112.
[92] City Code on Takeovers and Mergers:General Principles 1. Farrar 1998:594 calls it the basic principle on which the Code is founded.
[93] City Code on Takeovers and Mergers:General Principles 2.
[94] City Code on Takeovers and Mergers:General Principles 8.
[95] City Code on Takeovers and Mergers:General Principles 10. See also the discussion by Hutson 2000:12.

As early as 1953, it was regarded as good practice to extend to all shareholders the terms offered to those first approached, who might be the holders of the controlling interest in the target.[97]

In a number of ways, the Code makes provision for the equal treatment of shareholders. The terms of any offer made under the Code must be at least as favourable as on the terms of any acquisition made by the offeror for a period of 3 months prior to the commencement of the offer.[98] In addition, if any shares acquired during the offer are acquired at a price above the offer price during that offer, the offer price must immediately be increased to a price at least as high as the highest price paid.[99]

The key equal treatment provision is, however, the mandatory offer provision contained in Rule 9.[100] In fact, it has been described in the following terms:-

> 'The mandatory bid rule is a very strong expression of the Code's principle that all shareholders in the target company must be treated equally upon a change of control. Underlying the principle is the view that the prospects of minority shareholders in a company depend crucially upon how the controllers of the company exercise their powers and that the provisions of company law proper, ..., are not capable of protecting minority shareholders against unfair treatment, at least not in all cases.'[101]

As early as 1953, it was regarded as good practice to extend to all shareholders the terms offered to those first approached, who might be the holders of the controlling interest in the target.[102] In October of 1959, the Issuing Houses Association published a type of code under the title *Notes on Amalgamations of British Businesses* which contented that, as a general rule, an offer should be for the whole of the share capital of the company or for the whole of a class of shares. In May of that same year, the Board of Trade issued the Licensed Dealers (Conduct of Business) Rules which came into force in August 1960. These rules, *inter alia*, required that offers for less than the total amounts of shares should nonetheless be open to all shareholders, and that, should more acceptances be received, acceptances should be scaled down pro rata.[103]

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[96] City Code on Takeovers and Mergers:Definitions; Poser 1991:260.
[97] Johnstone 1980:11.
[98] City Code on Takeovers and Mergers:Rule 6.1; Poser 1991:262.
[99] City Code on Takeovers and Mergers:Rule 7.1; Poser 1991:262.
[100] Farrar 1998:594 – 595; Poser 1991:262.
[101] Davies 1997:792.
[102] Johnstone 1980:11.
[103] Johnstone 1980:19 – 23.

Since 1972, the Code has contained provisions aimed at requiring a compulsory bid to be made by an offeror who has managed to amass a significant number of shares in a company without making an offer.[104] Rule 9 applies the principle of equality to all shareholders when effective control is passed into new hands, protecting minorities who might be powerless in such a transaction.[105]

The rationale is derived from the notion that

> 'Shareholders should be given the chance to sell out of the company as they may have a low opinion of the new controller's business ability or methods, or they might not wish to remain in a company which had, say manufactured cars and was now to produce armaments'

and that

> 'the passing of control usually involves the payment of a premium over the market price. It is thought that all shareholders, not just the controller, should share the premium'.[106]

4.3.4.2 Making the mandatory bid

Provision is made for a mandatory bid in instances where[107] any person acquires shares which carry 30% or more of the voting rights of a company or where he/she already holds between 30% and 50% of the voting rights of a company and subsequently acquires further shares carrying voting rights in the company.[108]

The offeror is then required to make an offer for the remaining share capital of the company[109] in the following manner:-

> 'shall extend offers ... to the holders of any class of equity share capital whether voting or non-voting and also to the holders of any class of voting non-equity share capital in which such person or persons acting in concert

[104] Morse 1999:610;Morse 1995:831 – 832; Green 1992:12112 – 12113; Johnstone 1980:78.
[105] Barc 1997:T10/17.
[106] The Deputy Director-General of the United Kingdom Panel on Takeovers and Mergers as quoted by the Australian Parliamentary Joint Statutory Committee on Corporation and Securities. Commonwealth of Australia 2000:2. See also Lee 1993:198 – 199.
[107] City Code on Takeovers and Mergers:Rule 9.1. See also Hutson 2000:13; Begg 1999:9.33 and Farrar 1998:595.
[108] This provision is known colloquially as the 'creeper provision'.
[109] Younghusband 1998:7; Davies 1997:790; Morse 1995:832; CLERP Paper no 4:20; Poser 1991:263.

with him hold shares. Offers for different classes of equity share capital must be comparable.'[110]

This obligation rests not only on the offeror, but on each of the principal members of a group acting in concert with him/her.[111] The concept of persons 'acting in concert' with the offeror is defined in the Code as persons who actively co-operate with the offeror, pursuant to an agreement, to obtain or consolidate control through the acquisition of shares.[112] In addition, specific categories of persons are presumed to be persons acting in concert with the offeror, including a company, its parent company or subsidiary or associated company, a company with any of its directors and a company with any of its pension funds.

The making of an offer in terms of this rule must be conditional only upon the offeror's attainment of a shareholding of 50%, calculated upon the amount of acceptances received and amount of shares already held by the offeror.[113]

The Takeover Panel may waive the obligation to make the mandatory offer in instances where the required shareholding is reached through the issue of new securities as:-

a) consideration for an acquisition;
b) a cash injection; or
c) fulfillment of underwriting obligations.[114]

In terms of Rule 9 of the City Code the offeror must make an offer in cash at a price no lower than the highest price paid in the preceding twelve months.[115]

If the seller is a director of the target company, or a close relative or a related trust, he/she must ensure that the offeror undertakes to fulfil his/her obligations under this rule. In addition, such directors may not resign from the board of the target company until the offer is closed or becomes unconditional.[116]

The offeror is not allowed to exercise his/her newly acquired control until the offer document has been posted.[117]

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[110] City Code on Takeovers and Mergers:Rule 9.1.
[111] City Code on Takeovers and Mergers:Rule 9.2; Morse 1995:832.
[112] City Code on Takeovers and Mergers:Definitions. In the colloquialism of takeovers and mergers persons with a mere interest in the purchase of a dealing profit are known as a 'fan club' and are not liable in terms of these provisions. Morse 1999:610; Morse 1995:832.
[113] City Code on Takeovers and Mergers:Rule 9.3. Begg 1999:9.33.
[114] Younghusband 1998:8; Green 1992:[D]-0055; Poser 1991:263.
[115] City Code on Takeovers and Mergers:Rule 9.5; Brown 1999:52; Morse 1995:832.
[116] City Code on Takeovers and Mergers:Rule 9.6; Poser 1991:263.
[117] City Code on Takeovers and Mergers:Rule 9.7.

4.3.4.3 *The whitewash procedure*

It is also possible for the shareholders of the target company, after consultation with the Panel, to waive the mandatory bid, in a procedure known as a 'whitewash' by means of an independent note.[118] Appendix 1 to the City Code on Takeovers and Mergers contains a number of guidelines in relation to such notes.

The following broad requirements are set for a whitewash. Firstly, no disqualifying transaction may have been entered into by the persons seeking the waiver in the preceding twelve months – such transactions include, for instance, the issuing of new shares to the offeror.[119]

Secondly, the parties concerned must consult with the Panel. The Panel must approve a circular to be issued to all shareholders, prior to the issuing of that circular, which must set out the following details:-

a) competent independent advice on the proposed transaction, the controlling position it will create and the effect this will have on the shareholders generally;
b) full details of the maximum potential controlling shareholding;
c) the fact that it may be possible to achieve a shareholding in excess of 49% and that it may then possible to increase this shareholding without incurring the obligation to make the mandatory offer;
d) the identity of the possible controlling shareholders;
e) a statement that the Panel has agreed to waive such a mandatory bid, should the shareholders approve it; and
f) a range of information normally required in terms of other rules of the Code; and

Finally, approval of these proposals by an independent vote or poll at a meeting of shareholders of any relevant class of securities, is required.[120]

The mandatory offer, in terms of this rule, may be made conditional upon the approval of the offer by the Monopolies and Mergers Commission and the European Commission.[121]

4.3.4.4 *Conclusion*

This rule achieves a number of objectives. It ensures that all shareholders share equally in any premium paid by an offeror, provided that at least 30% of the shares in the company are

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[118] Green 1992:12113.
[119] For the purposes of these provisions, the term 'offeror' refers to the potential controlling shareholders.
[120] See also Begg 1999:9.33 – 9.34.
[121] City Code on Takeovers and Mergers:Rule 9.4.

sold. It protects non-selling shareholders against the risk of exploitation by the new controlling shareholder and eliminates the possibility that the shares of the non-selling shareholders are acquired in a so-called freeze-out merger for a consideration considerably less than that paid in the execution of the original bid or tender offer.[122]

It is, however, possible to acquire shares without invoking the mandatory offer obligation, when those shares are purchased in one of the following four manners:-

a) acquisition of shares from a single shareholder in the only such transaction in a period of seven days where the acquirer has not issued an announcement of a firm intention to make an offer;
b) immediately preceding a firm intention to make an offer, publicly recommended by the board of the offeree company and conditional upon that intention;
c) under certain specified conditions an acquisition by someone who has made an announcement of a firm intention to make an offer; and
d) an acquisition which constitutes the acceptance of an offer.[123]

It is clear that the mandatory bid obligation offers substantial protection to minority shareholders when applied in the circumstances for which it was designed. It is, however, possible to circumvent this obligation in those same circumstances employing other methods of share acquisition. This renders the efficacy of the protective measure largely dependent on variable circumstances.

4.3.5 Other provisions embodying the equality principle

Rule 11.1 governs the nature of consideration to be offered when a cash offer is required. This rule requires that the first general principle, namely that all shareholders of the same class must be treated equally by the offeror, be applied strictly and that the highest consideration be paid during the preceding twelve months.[124]

Comparable offers are required in terms of rule 14 in instances where there is more than one class of share capital. This requirement relates to both voting shares and non-voting shares.

Rule 20 governs equality of information, not only to shareholders, but also to competing offerors. Information must be made available equally to all shareholders and must be made available at more or less the same time.[125] In addition, information, including information on

[122] Demott 1987:95.
[123] City Code on Takeovers and Mergers:Rule 5.2; Poser 1991:264.
[124] City Code on Takeovers and Mergers:Rule 11.1.
[125] City Code on Takeovers and Mergers:Rule 20.1.

shareholders, given to one offeror, must be provided equally and promptly to any other offeror on request, even if that offeror is less welcome.[126]

These principles all represent the principle of equality as it is employed to safeguard the interests of all shareholders in an affected transaction. The emphasis on equality of consideration and equality of information stresses the importance of the principle of equal opportunity as the primary shareholder protection mechanism in takeovers and mergers.

4.4 The acquisition of shares from dissenting shareholders

The current provisions on the compulsory acquisition of shares as contained in Chapter XIIIA of the Companies Act 1985 were inserted by Schedule 12 to the Financial Services Act of 1986.[127] These provisions stem from the recommendations of the Greene Committee, which were implemented in 1928 and were contained in sections 180 and 185 of the 1948 Companies Act.[128]

The provisions were enacted to increase the protection of dissentient shareholders or those shareholders whose shares the offeror has not acquired or contracted to acquire at the time at which notice is given under these provisions.[129] These shareholders were referred to as 'minority shareholders' in the applicable bill.[130]

Perhaps more pragmatically, the additional functions of preventing non-acceptors of a takeover offer from defeating the offeror's plans to make the target company a wholly-owned subsidiary and 'tidying up' after a successful takeover offer, has been ascribed to these provisions.[131] These provisions have also been described as facilitative of takeovers.[132]

Section 428 to 430F makes provision for the acquisition of the shares of dissenting shareholders.[133] Section 428 contains a number of context-specific definitions of some of the terms used in these provisions. One of the most important of these definitions is the definition of the term 'take-over',[134] which qualifies those transactions to which these provisions will be applicable, in the following terms:-

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[126] City Code on Takeovers and Mergers:Rule 20.2.
[127] Boyle and Sykes 1986:30.019.
[128] Lategan 1980:11.
[129] Shepherd 1995:273; Hollington 1994:123 – 125.
[130] Wooldridge 1986:300.
[131] Morse 1999:617; Goldberg 1999:273; Poser 1991:279.
[132] Farrar 1988:607.
[133] Green 1992:12070; Creamer et al 1987:121.
[134] Abbott 1993:305.

It is an offer to acquire all the shares, or all the shares of a class of shares in the target company, other than those held by the offeror, and it is substantially an offer for all such shares on the same terms.[135]

The shares involved must also be shares to which the offer relates. In the calculation of such shares, the following shareholding is not taken into consideration:-

a) shares already held by the offeror;

b) shares the offeror contracted to buy at the date of the offer; and

c) shares already held by an associate of the offeror.[136]

4.4.1 The right to compulsory acquisition

Upon acceptance of that offer by 90% of the disinterested shareholders,[137] the offeror acquires the power to forcibly purchase the shares of the dissenting shareholders.[138] This power applies to all shares, but not to debentures.[139]

Upon acceptance of the offer by the prescribed number of shareholders,[140] the offeror issues an acquisition notice to the remaining shareholders,[141] informing them that he/she wishes to acquire their shares.[142] The effect of this notice is that the offeror is then entitled and bound to acquire the shares of the remaining (and therefor dissenting) shareholders.[143]

The consideration to be paid for these shares is on the same terms as during the offer.[144] If the main offer entailed a choice of consideration, then the notice described above must also contain the particulars of that choice and make it available to the remaining shareholders.[145]

Six weeks from the end of this notice, compulsory acquisition may then be effected by the offeror through the transfer of the consideration for shares to the company, accompanied by a

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[135] Boyle and Sykes 1986:30.020; Green 1992:12072; Wooldridge 1986:301 – 302.
[136] Morse 1999:618; Mayson, French & Ryan 1999:248 – 249; Morse 1995:843; Abbott 1993:306.
[137] Such acceptance must be achieved within a period of four months. Mayson, French & Ryan 1999:249; Morse 1995:844.
[138] Companies Act 1985:s 429 – 430; Goldberg 1999:273; Davies 1997:808; Shepherd 1995:274; Morse 1995:844.
[139] Boyle and Sykes 1986:30.022.
[140] As is the case in South Africa, such acceptance has to occur within four months of the making of the initial offer.
[141] Issuing such a notice is not compulsory. Shepherd 1995:274.
[142] Companies Act 1985:section 429.
[143] Davies 1997:808; Shepherd 1995:274; Green 1992:12075.
[144] Mayson, French & Ryan 1999:249; Goldberg 1999:273; Abbott 1993:306.
[145] Boyle and Sykes 1986:30.022.

copy of the notice and an instrument of transfer executed on behalf of the shareholder by a person appointed by the offeror.[146]

4.4.2 The right to be bought out

In instances where the offeror makes an offer for all the shares of the target company and that offer is accepted by 90%[147] of the of the holders of such shares in value,[148] minority shareholders are afforded two rights in terms of these provisions:-

a) they may compel the offeror to buy them out on the terms of the offer; and

b) they may approach the court for an order to the contrary.[149]

Should the dissenting shareholders elect to be bought out, they may elect to do so on the terms of the offer. Any choice of consideration offered during the main bid, is preserved. Should the parties not be able to agree upon consideration, then either party may approach the court, which may, in turn, make such an order as it deems fit.[150]

This option presents useful protection for those minority shareholders effectively locked into a company under overwhelming new control.[151]

4.4.3 The application to court

Dissenting minority shareholders may also approach the court for an order preventing the compulsory acquisition or prescribing different terms for the acquisition.[152]

The courts will grant an order preventing the compulsory acquisition where the applicant discharges the onus of proving that the scheme as a whole was unfair to all the shareholders.[153] The onus rested upon the shareholders bringing such an action is, however, a heavy one.[154]

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[146] Mayson, French & Ryan 1999:250; Morse 1995:845; Boyle and Sykes 1986:30.023.
[147] In the calculation of this level of shareholding, the securities already held by the offeror is also taken into consideration. These shares are not taken into consideration when the required level of shareholding for the compulsory acquisition of shares is calculated.
[148] Green 1992:12070.
[149] Mayson, French & Ryan 1999:251; Farrar 1998:610; Morse 1995:845; Green 1992:12070 – 12071.
[150] Boyle and Sykes 1986:30.023.
[151] Davies 1997:809; Boyle and Sykes 1986:30.024.
[152] Companies Act 1985:section 430C(1). See also Hollington 1999:160; Mayson, French & Ryan 1999:250; Goldberg 1999:274.
[153] Farrar 1998:608; Green 1992:12077.
[154] Goldberg 1999:274; Boyle and Sykes 1986:30.025.

This test is awkward due to the fact of judicial reliance upon the fact of acceptance by nine tenths of the shareholders in the company as proof of fairness.[155] In addition, shareholders in this position rarely have access to the expert advice and corporate information the offeror may have at his command. This becomes especially critical when it is taken into consideration that a scheme will be adjudicated unfair as a whole if the acceptance of the offer was based upon substantial misrepresentation to the accepting shareholders.

Though factors such as these hamper the exercise of this right by shareholders, section 430C(4)[156] enjoins the court, as a general rule, to award costs even in instances where dissenting shareholders fails with the application brought.[157] This provision has the effect of encouraging dissenting minority shareholders to exercise such rights if they are of the opinion that the scheme, as a whole, was not fair.

It is also possible for minority shareholders to effect a so-called reverse compulsory purchase through addressing a written communication to the offeror requiring him/her to acquire his/her shares.[158] This may be done in instances where the offer of the offeror has been accepted by nine tenths of all shareholders and not only 90% of the so-called disinterested shareholders.[159] Once such a notice has been issued, the offeror is entitled and bound to acquire the shares on the terms agreed upon.[160]

4.5 Compliance with the EU directives

The United Kingdom joined the European Community in 1973, and since that date the obligation to comply with EEC directives have led to many major reforms to British company laws.[161]

The Companies Act 1985 already complied with the third directive as issued. Those aspects not initially covered by section 425 – 430 of the act, were later implemented by section 427A and schedule 15A of the 1985 act[162] by the Companies (Mergers and Divisions) Regulations issued in 1987.[163]

The United Kingdom would not face the introduction of any significant amendments to takeover regulation in order to implement the provisions of the thirteenth directive. In fact, the

[155] Shepherd 1995:275; Boyle and Sykes 1986:30.024.
[156] Companies Act 1985.
[157] Boyle and Sykes 1986:30.024.
[158] Companies Act 1985:section 430A(1).
[159] Green 1992:12079.
[160] Companies Act 1985:section 430C(3).
[161] Green 1992:16007.
[162] Delport 1992:201.

framework thirteenth directive is, to a large extent based on the provisions of the Code.[164] Nevertheless, the United Kingdom was one of the directive's early antagonists.[165]

One of the major concerns of the United Kingdom's Department of Trade and Industry on the proposals contained in the thirteenth directive, was that a statutory base for the Code,[166] as discussed above, would lead to the English courts asserting jurisdiction, unleashing the full might of judicial review.[167] The 1996 proposal, however, made provision for member states to designate a self-regulatory authority as governing body, provided its present non-statutory powers are considered sufficient.[168]

Other concerns included that the current system of consultation prior to the execution of a bid and during a bid would be damaged by the regime proposed and that the current flexibility in the regulatory regime would be lost.[169] This concern has, ironically been obviated by the amendment effect by the United Kingdom to its won regulatory regime.[170]

4.6 Conclusion

It is quite clear that the mandatory bid is firmly entrenched in the law of the United Kingdom where it serves to protect minority shareholders from being locked into companies of which the control shifts hands. This is in line with the South African interpretation of the mandatory bid. The rationale behind the obligation to make the mandatory offer is very well elucidated in this jurisdiction and the belief firmly entrenched that it is indeed one of the only ways in which minority shareholders can be adequately protected.

In the following chapter the reception of this bid construction into both transnational European law and the law of other jurisdiction will be examined, and in the final chapter the South Africa obligation, as it is based on the British obligation, will also be examined. This comparison and evaluation will serve to juxtaposition the efficacy of the obligation in various jurisdiction.

The procedures relating to the compulsory acquisition of shares present a two-edged sword. On the one hand it gives an aggressor the power to expropriate the shareholding of minority shareholders should he/she choose to do so. This appears to be the very antithesis of minority shareholder protection. On the other hand, the same provisions give minority

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[163] Green 1992:16034.
[164] Boyle and Sykes 1986:38.010.
[165] Morse 1999:603.
[166] Boyle and Sykes 1986:38.010.
[167] Brown 1999:51; Andenas 1996:150.
[168] Andenas 1996:151.
[169] Boyle and Sykes 1986:40.016.
[170] See the discussion at 4.3.2 above.

shareholders the power to exit the company at a good price and to contest the offeror's attempt at compulsory acquisition. In addition to these safeguards, the court is granted a substantial discretion in deciding on the fairness of the transaction as a whole, once the minority shareholders have approached a competent court.

It is, however, as has been mentioned above, necessary to examine a very recent aspect of the European harmonisation process to glean some more information on exactly how important a role the mandatory bid plays in the protection of minority shareholders.

CHAPTER 5

THE LAW OF THE EUROPEAN UNION AND THE LAW OF SELECTED MEMBER STATES

5.1 Introduction

The European integration process relies on the mobility (and freedom of movement) of labour, capital, persons and goods.[1] Accordingly, companies in the European Union are free to migrate to patterns shaped by the competition in their respective industries.[2] One of the implications of this trend towards cross-border corporate mobility, is an increase in takeovers, mergers and the formation of joint ventures. Another is the harmonisation of company, stock exchanges and securities law.[3]

This trend is in line with the stated aim of the community to promote the harmonious development of economic policies and the gradual removal of any obstacles to freedom of movement.[4] Inherent to his freedom of movement is the right to set up and manage undertakings.[5] This harmonisation process has been concentrated on four main areas:

a) the harmonisation of national corporate law systems with reference to their contents;
b) the mutual recognition of national corporations amongst the member states;
c) the creation of mechanisms for cross-border mergers of national corporations; and
d) the creation of supra-national forms of business enterprise.[6]

This chapter will, after an overview of competition regulation in the European Union, focus on the supra-national regulation of takeovers and mergers in company law. The third, fifth and tenth directives will be reviewed in so far as they relate to the protection of minority shareholders.

This chapter, however, focuses largely on the proposed thirteenth directive and, more specifically, on the evolution of the mandatory bid in the various revisions of that instrument.

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[1] Bovis 1997:41; Mathijsen 1995: 167, 184, 212; Raaijmakers 1989:1.
[2] Bovis 1997:41.
[3] Raaijmakers 1989:1.
[4] For a discussion on the mobility of companies in the Euroepan Union, see Cerrioni 1999:59 – 79.
[5] Delport 1992:198-199; Depser 1991:483.
[6] Blaurock 1998:381 – 382.

Finally, the takeover codes and/or legislation of three member states, Austria, Sweden and Germany, will then be examined in order to evaluate the manner in which member states have reacted to the anticipated new obligations under the thirteenth directive.

5.2 The regulation of takeovers and mergers in Competition Law

Pursuant to a wave of mergers in the 1960's, the European Commission published a memorandum on so-called 'concentrations' and suggested the regulation of mergers with recourse to sections 85 and 86 of the EEC Treaty: articles primarily aimed at the regulation of competition in the community.[7] For a number of reasons, section 85 was not considered suitable to this task.[8] Section 86 was, however, deemed suitable to effect merger control from a competition perspective.[9]

The first proposal for the supra-national regulation of takeovers and mergers was presented to the Council of Ministers in 1973, but only in 1988 did the Council agree to the drawing up of a merger control regulation. This regulation was finally approved in 1989.[10]

The merger control regulation makes provision for the existing merger control dispensation in the United Kingdom, Germany and France and is based on the following principles:-

a) it applies only to European Community dimension concentrations above certain thresholds;
b) it comprises mandatory *ex ante* notification and automatic suspension provisions; and
c) on a competition level, it prohibits mergers which either create or strengthen a dominant position.[11]

A Merger Task Force ensures that cases are handled promptly and efficiently.[12] This type of competition regulation has the combined aims of a diffusion of economic power and the encouragement of the economic freedom of market participants, coupled with efficiently allocating resources to the maximum satisfaction of consumers.[13]

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[7] Bovis 1997:42.
[8] The reasons relate to the specific context of section 85, and include:-
a) the unsuitability of the limited time exception criteria;
b) the inaptness of the sanction of nullity;
c) the fact that the provisions could technically not apply to hostile takeovers; and
d) the fact that the Commission would not be able to administratively handle the amount of notification in terms of those sections in periods suitable to mergers.
[9] *Europmballage Corp. and Continental Can v EC Commission* [1973] ECR 215; Bovis 1997: 44; Banks 1999:149. See, however, the discussion by Kerres 1991:7 – 8.
[10] Bovis 1997:47 – 49.
[11] Bovis 1997: 50.
[12] Krause 1995:627.

5.3 The supra-national regulation of takeovers and mergers in company law

The regulation of takeovers and mergers in the European Union has two interrelated dimensions, namely supra-national regulation and national regulation. National regulation, in turn, has been affected by the European Union regulations and other directives aimed at the harmonisation or approximation of the applicable laws.[14]

Such directives are binding on member states as to the result to be achieved. In turn, it is in within the discretion of each member state to determine the mechanism of implementation.[15] In turn, a regulation has general application and is entirely binding upon member states.[16] Inherent to this whole notion of complimentary supra-national and national regulation is the principle of subsidiarity, which entails achieving a degree of harmonisation while affording member states a wide discretion to take cultural, market and national differences into account.

Such discretion is then balanced by the need to establish at least harmonised minimum standards, lest the European Union too, be beset by the so-called Delaware effect,[17] or the race to the bottom.[18] As is the case in the other jurisdictions studied here, the regulation of takeovers and mergers in the European Union has both a competition law and a company law dimension.

National regulation of takeovers in the Member States of the European Union differs greatly. Denmark and Greece boast no relevant legislation, primarily due to the fact that takeovers are virtually unknown. Germany, Italy, the Netherlands and the United Kingdom all have codes of conduct for offerors and offerees to observe during such transactions. Spain, France and Portugal regulates takeovers by means of statutory provisions and in both Belgium and Luxembourg a statutory body is tasked with the supervision of takeovers.[19]

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[13] Portwood 1994:6.
[14] The term 'approximation' refers to the replacement of dissimilar national rules by uniform provisions when this is required for the establishment and functioning of the common market. Mathijsen 1995:262.
[15] Treaty of Rome:sec 189.
[16] Treaty of Rome:sec 189; Delport 1992:199.
[17] The Delaware effect entails that, where a differential system of companies regulation be allowed to develop within a single economic system, there will be a corresponding tendency to establish companies in those members states (historically in the United States and potentially in the European Union) which have a liberal company law with little requirements and regulation.
[18] Van Hulle 1989:12.
[19] Depser 1991:484.

Four instrument for the transnational regulation of takeovers and mergers will now be studied, namely the third, fifth, proposed tenth and proposed thirteenth directives.

5.3.1 The third directive

The third directive[20] of 1978[21] contains the rules applicable to mergers effected by means of the acquisition of one or more companies and to mergers achieved by the formation of a new company within a member state.[22]

The primary purpose of the directive is the introduction of the concept of especially mergers in all Member States and the facilitation of such mergers,[23] and is evidenced by the stated purpose of the directive:-[24]

> 'Whereas the protection of the interests of members and third parties require that the laws of the Member States relating to mergers of public limited liability companies be coordinated and that provision for mergers should be made in the laws of all the Member States;
>
> whereas in the context of such coordination it is particularly important that the shareholders of merging companies be kept adequately informed in as objective a manner as possible and that their rights are suitably protected.'

In addition, the provisions are aimed at harmonising national laws and contain some measures aimed at the protection of minority shareholders. Article 8,[25] for instance exempts members states from enacting a statutory requirement that a merger be approved in general meeting when one or more shareholders holding a minimum percentage of the share capital are entitled to require that such a general meeting be called. Though it would be possible for a majority to outvote such a minority shareholder, a statutory mechanism is at least guaranteed enabling minority shareholders to table concerns within the constraints of the corporate democracy.

The third directive also contains provisions directing member states to make the following statutory provisions relating to situations where the offeror holds at least 90% of the shares in the target company:-

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[20] 78/855/EEC (OJ 1978 L295/36).
[21] The first proposal for the directive was submitted to the Council on 16 June 1970, amended twice and finally adopted on the 9th of October 1978.
[22] Aretz 1993:11; Delport 1992:201; Wooldridge 1991:34; Dine 1989:324.
[23] Boyle and Sykes 1986:38.003.
[24] Third Council Directive of 9 October 1978 78/855/EEC.

a) a general meeting need not be called to approve the meeting if article 8(c) as described above applies;[26]

b) the detailed provisions contained in articles 9 to 11 relating to the furnishing of a report to shareholders and the information that should be made available for their inspection need not apply if the following obligations are met:-

   i) the minority shareholders of the target company must be entitled to have their shares acquired by the acquiring company;

   ii) should those shareholders elect to exercise that right, they must be entitled to receive consideration equivalent to the value of their shares; and

   iii) in the event of disagreement on the consideration, it should be possible that a court determine such value.[27]

This obligation closely reflects the more positive aspects of the compulsory acquisition procedures we have encountered in United Kingdom law. It offers the minority shareholder an opportunity to exit the company with fair compensation for his/her shares. Both the opportunity to dispose of the shares and the price guarantee reflects the equal opportunity principles discussed above.

5.3.2 The fifth directive

The fifth EEC directive is aimed at the harmonisation of a number of aspects of company law within the Community in so far as those provisions relate to the management structures of companies,[28] worker participation in the management of companies[29] and procedural issues relating to the powers of the general meeting and the rights of shareholders and minorities.[30]

In fact, one of the primary objectives of the directive ensuring that the laws of Member States are co-ordinated in order to give equivalent protection to members and others.[31]

Article 16 allows minority shareholders with a shareholding of as little as 10% to initiate proceedings against the directors on behalf of the company. This article, coupled with the provisions of article 14, which compels Members States to ensure that compensation for damages to the company can be claimed through the civil liability of the members of the

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[25] Third Council Directive 78/855/EEC:article 8(c).
[26] Third Council Directive 78/855/EEC:article 27.
[27] Third Council Directive 78/855/EEC:article 28.
[28] In its initial stages, the directive contained a proposal that all companies have both an executive and a supervisory board.
[29] Dine 1989:327.
[30] Boyle and Sykes 1986:39.016.
[31] Boyle and Sykes 1986:39.016.

management of the company, allows for a derivative action on the widest possible grounds.[32] The United Kingdom has argued against this provision and has suggested that it be limited to instances where the action complained of is either illegal or *ultra vires*.[33]

In addition, section 18 of the current proposal allows the company to renounce the right to bring such proceedings by means of a resolution in general meeting.[34] Such a resolution may, however, not be made against the votes of the minority referred to in terms of section 16.[35]

These safeguards are not specifically applicable to takeovers and mergers and present the type of protection afforded all shareholders in terms of proper information on the management of the company and an appropriate opportunity to participate in that management.

5.3.3 The tenth directive

A draft tenth directive was submitted to the Council of Ministers in January of 1985. Though the European Parliament refused to give a final opinion on the directive, but it has not yet been formally withdrawn.[36] This draft commenced its existence as a draft convention.[37]

The tenth directive supplements the third directive but makes provision for mergers between companies governed by the differing national laws of members states by extending the provisions of the third directive wherever relevant.[38] This means that the specific type of merger to which the directive is applicable is that kind of merger which has the result that one of the companies involved in the merger (or both) are ultimately dissolved.[39]

The initial proposal provided that cross-border mergers as regulated, should have the approval of at least two thirds of the shareholders (by vote) in general meeting. In addition, provision was made for the engagement of at least one independent expert to supply a report to shareholders.

The tenth directive is classified by some authors on the subject under the heading 'Takeovers and barriers thereto'.[40] Such barriers are mainly the result of varying company law provisions in Member States that may allow that the control of a company remains in the hands of

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[32] Xuereb 1989:176.
[33] Green 1992:16210.
[34] Xuereb 1989:177.
[35] Green 1992:16211.
[36] Green 1992:16226.
[37] Wooldridge 1991:41.
[38] Aretz 1993:12; Delport 1992:204.
[39] Aretz 1993:12.
[40] Boyle and Sykes 1986:40.001.

shareholders even beyond the takeover due to weighted voting rights. Such obstacles may hamper the restructuring of companies in the European Union.[41] In addition, it has been criticised as regulating cross-border mergers as a means of escaping worker participation provisions.[42]

5.3.4 The proposed framework thirteenth directive

The proposed thirteenth directive is firmly established in the notion that

> 'it is necessary to protect the interests of shareholders of companies governed by the laws of a Member State when these companies are subject to a takeover bid or to a change of control...'[43]

In addition, it recognises that

> 'Member States should take the necessary steps in order to protect shareholders having minority holdings after the purchase of control of their company;'[44]

The thirteenth directive on takeovers and mergers has been designed to ensure that all shareholders of listed companies within the single market will enjoy equivalent safeguards in the case of a change of corporate control.[45] It prescribes the minimum standards that member states should adopt to regulate takeovers within the state,[46] and accordingly it has been described as an attempt to create a more level playing field for takeovers in Member States of the European Community.[47]

The provisions of the directive will be applicable to all public companies governed by the law of a Member State.[48]

One of the most important features of the thirteenth directive for the purposes of this study, is that is proposes to implement the mandatory bid as a means of statutory minority protection in the member states of the European Union. This obligation has also been interpreted as a right

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[41] Commonwealth of Australia 2000:11.
[42] Dine 1989:327.
[43] Amended proposal for a 13th European Parliament and Council Directive on company law concerning takeover bids 97/C 378/09:preface.
[44] 97/C 378/09:preface.
[45] Dine 1996:201; Aretz 1993:12.
[46] Delport 1992:204.
[47] Depser 1991:485.
[48] Boyle and Sykes 1986:40.007.

of withdrawal for shareholders.[49] The directive also proposes to provide the means of determining the competent regulatory authority and the law applicable to each particular takeover, which are of crucial importance to cross-border takeovers. In addition, provision will be made for a minimum level of disclosure and information, thus guaranteeing transparency.

At present, varying degrees of shareholder protection exist in the European Union. Some states do not require that a mandatory offer be made to all holders of the same class of shares. In addition, the defensive measures permissible in a takeover situation vary between the member states.[50]

The first proposal for a thirteenth directive was tabled in 1989 and amended in 1990.[51] A more streamlined version was tabled in 1996 and amended in 1997. A reservation on the issue table by Spain concerning Gibraltar prevented the adoption of the directive on the 21st of June 1999, and the proposal was due for reconsideration at the 7 December 1999 meeting of the Internal Market Council of the European Union.[52]

This directive was identified in the May 1999 Action Plan for Financial Services as a key element for integrated financial markets.

5.3.4.1 The 1989 – 1990 proposal

The City Code on Takeovers and Mergers[53] of the United Kingdom provided the model for the first proposal on the thirteenth directive.[54] The aims of the directive are clear from the introductory motivation for the directive:-

> 'Whereas it is necessary to protect the interests of the holders of the securities of companies governed by the law of a Member State when the securities of these companies, admitted to trading on a regulated market within the scope of this Directive, are the subject of a takeover or other general bid;
>
> whereas equality of treatment of holders of securities require that persons whishing to attain a certain level of holdings in a company be obliged to make a bid; whereas in order to protect persons having minority holdings and avoid

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[49] Lüttmann 1992:497.
[50] Farrar 1998:600.
[51] Hutson 2000:15.
[52] http://www.europa.eu.int/comm/internal_market/en/company/company/35.htm.
[53] See the discussion on the Code at 4.3.1.2 below.
[54] Andenas 1996:105.

> purely speculative partial bids, it is necessary to require that persons who have acquired a considerable holding make a bid for all the securities of the company; whereas, in order to attain greater flexibility in the application of this provision, the Member States may provide for a series of exemptions from this obligation;[55]

The directive set out a number of principles that should be applied by the regulatory authority when making its decisions.[56] All holders of the same securities in an offeree company should be treated equally and offerees in a takeover bid should be afforded ample opportunity to reach a properly informed decision with sufficient time and information to their disposal. In addition, the board of the offeree company must act in the best interests of all the shareholders and cannot frustrate a bid *mero motu* and a false market for the securities of either the offeror or offeree company should not be created by as a consequence of the bid. Finally, a reasonable time for the bid should be allowed lest the affairs of the offeree company are unduly hampered.[57]

Provision was made for a mandatory offer obligation in this proposal, but the obligation was not satisfactorily developed, leaving the determination of price in the discretion of the member states.[58] This meant that it was possible for the consideration offered in terms of the obligation to be detrimental to shareholders. It also meant that the principle of equal treatment was not seen through in full consequence.

The level of shareholding which would trigger the obligation was also not defined, but was given a ceiling of a third of the shares in the company. In the calculation of this percentage, the following voting rights had to be added to those held by the offeror:-

a) those belonging beneficially to the owner;
b) those held by undertakings controlled by the offeror;
c) those held by persons acting in concert with the offeror;[59] and
d) those lodged as security, save in instances where the holder indicated an intention of exercising them.[60]

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[55] Amended proposal for a Thirteenth Council Directive on Company Law concerning takeover and other general bids COM (90) 416 final.
[56] See the discussion at 5 below on the formulation of the application of similar principles in Australian law – they are not, as is the case in South Africa principles underlying the prescribed code, but principles taken into consideration by the regulatory authorities in the execution of their duties.
[57] Article 10; Delport 1992:204; Boyle and Sykes 1986:40.006.
[58] Article 4; Andenas 1996:150; Wooldridge 1991:147.
[59] The term 'persons acting in concert' was defined in article 2 as 'persons who, through concerted practices or pursuant to an agreement, co-operate with one another in connection with a bid.
[60] Article 4; Boyle and Sykes 1986:40.008.

To this was to be added any holdings by the persons mentioned above in the form of securities in which they have a life interest, securities which they are entitled to acquire, either under a formal agreement or on their own initiative and voting rights at their disposal.[61]

The article also created leeway for the supervisory authority appointed to create and allow exemptions from the mandatory bid in an unstructured manner. Technically, an unlimited discretion to grant exemptions is created, lessening the harmonisational effect desired.[62]

The following advantages of the mandatory offer has been put forward:-

a) such a general bid would prevent a stampede of partial bids;

b) all shareholders will be empowered to participate in the premium paid by the offeror for control of the company by providing all shareholders with an equal opportunity to sell;

c) minority shareholders will be allowed to opt out of the company in view of the fact that a change in control may lead to a change in corporate policy; and

d) the mandatory offer is justified in view of the future harm that may come to the company.[63]

The second draft of the proposal was submitted on the 14th of September 1990, pursuant to the recommendations of the Economic and Social Committee, the European Parliament and the Member States.[64] It encompassed four major amendments, one of which rendered it applicable only to companies listed on a stock exchange in relation to a general takeover bid.[65]

Article 3 of the proposal contained the mandatory bid obligation on the following terms: the obligation was triggered by a 33.3% shareholding.[66] The underlying principle to this provision was that of the equal treatment of shareholders and as a consequence, the provision was aimed at the protecting minority shareholders against the loss of the value of their shares pursuant to a partial bid.[67]

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[61] Boyle and Sykes 1986:40.008.
[62] Boyle and Sykes 1986:40.022.
[63] Lüttmann 1992:497.
[64] Depser 1991:485.
[65] Delport 1992:204.
[66] This threshold was selected due to the fact that a shareholder with such a shareholding has enough power to exercise a blocking vote. The percentage was to be calculated with due consideration to the shareholdings of persons connected with the offeror.
[67] Depser 1991:485.

Both the threshold and the obligation to make a bid for all of the remaining shares in the target company troubled the Member States who suggested a general easing of the proposed requirements.[68]

A number of exception to the obligation were also developed and contained in the proposal:-

a) acquisition without consideration;
b) acquisition within the framework of a protected takeover;
c) instances where the threshold was exceeded by less than 3% of the voting rights and an undertaking was given to return below the threshold within a year;
d) where the company was already under the control of the acquirer;
e) where the increase in shareholding results from the exercise of a right of pre-emption.[69]

5.3.4.2 The 1996 proposal

After the rejection of the 1991 proposal, the European Commission tabled a proposal in the form of a framework directive.[70] A framework directive comprises three elements. Firstly, it sets up a number of general principles which the member states must apply to all their regulation.[71] Secondly, a number of minimum requirements are set up[72] and finally, it lists a number of issues that the Members States must deal with in their regulation, without an indication of the contents of that regulation.[73]

The principle most critical to this study, namely that of equal treatment, was amended in this proposal from a requirement that all holders in the same position be treated equally, to a requirement that all holder in the same position are to be given equivalent treatment.[74]

One of the amendments most significant to the topic of this study is that that 1996 framework directive no longer treats the mandatory bid as the only means to protect minority shareholders.[75]

Article 3 of the draft requires that a members state provide rules requiring that either a person (including a legal person) who acquires holding that, together with any shares already held,

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[68] Depser 1991:485.
[69] Depser 1991:485.
[70] Radcliffe 2000:40.
[71] In this instance it would relate foremost to the requirement of the equal treatment of all shareholders. See especially Farrar 1998:600 – 601.
[72] The mandatory bid would be a good example of such a minimum requirement.
[73] Clausen 2000:43.
[74] Amended proposal for a 13th European Parliament and Council Directive on company law concerning takeover bids 97/C 378/09:Article 5.

will give him/her a specified percentage of the voting rights in the target company, make a bid to all shareholders for all or a substantial part of their shareholding or such a person offer other appropriate and at least equivalent means in order to protect the minority shareholders in that company.[76]

It is left to Members States to determine what constitutes control and what level of percentage holding is required to trigger the obligation to be imposed in terms of this directive.[77]

Article 10 proposed to place an obligation on members states in relation to the mandatory bid in the following terms:-

> 'Where a member states provides for a mandatory bid as a means to protect the minority shareholders, this bid shall be launched to all shareholders for all or for a substantial part of their holdings at a price which meets the objective of protecting their interests.'

This wording was amended in the consequent proposal in the following manner:-

> 'Where a Member State provides for a mandatory bid as a means to protect the minority shareholders, this bid shall be launched to all shareholders for all or a substantial part of their holdings at a price which *ensures equal treatment for shareholders. The term 'substantial part' should not be interpreted as meaning less than 70% of the securities except where duly justified authorisation has been given by the supervisory authority.*'[78]

The second requirement remained the same:-

> 'In the mandatory bid comprises only a part of the securities of the offeree company and the shareholders offer to sell to the offeror more shares than the partial offer covers, shareholders should be treated equally be means of a pro rate treatment of their shareholdings.'

The protection compelled by this provision is by no means complete. No threshold is prescribed and the exact nature of protection equivalent to that offered by the mandatory bid, vague.[79] The term apparently refers to the type of provisions contained in German regulation

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[75] Hutson 2000:15; Dine 1996:204.
[76] Dine 1996:204.
[77] Voss 1999:77.
[78] Amended proposal for a 13th European Parliament and Council Directive on company law concerning takeover bids 97/C 378/09:Article 10.
[79] Dine 1996:205.

of company groups which enables shareholders to either claim recurrent payments or withdraw from a subsidiary, or claim damages against the mismanagement of the dominant company.[80]

Despite this, article 5[81] of the draft sets out, as one of the principles which will guide the regulatory body that all holders of the securities of an offeree company who are in the same position are to be treated equally.[82]

5.3.4.3 The 1999 proposal

By 1999, the possibility that member states could keep or introduce means at least equivalent to the mandatory offer for the protection of minority shareholders on the statute books, had been abandoned. The proposed directive requires all member states to introduce the mandatory bid rule to guarantee equal protection for minority shareholders.[83] This was seen as the only means of protecting the minority shareholders of a listed company.

The general principles in the latest draft include that there must be equivalent treatment of all holders of securities of the same class and that the board of a company must act in the interests of the company as a whole.[84]

Article 5 lays down the requirement that a mandatory bid be required to all shareholders where the offeree acquires a certain portion of the voting rights in the target company. Member States that provide an equivalent means of protecting minority shareholders are given an extra year to adapt to this requirement. In addition such states may continue providing the additional equivalent protection, provided that these measures do not hamper takeovers.[85]

Setting the threshold of shareholding that would trigger the obligation is still left to the discretion of the Member States.[86]

Political agreement to the directive was reached in June of 1999.[87] Only Spain and the United Kingdom had to resolve an issue concerning takeover authority for Gibraltar.[88] Though the

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[80] Voss 1999:78; Dine 1996:205.
[81] Article 5(1)(a).
[82] Dine 1996:210.
[83] Hutson 2000:14. See also http://www.europa.eu.int/comm/internal_market/en/company/company/35.htm.
[84] Hutson 2000: 15; Green 1992:16231.
[85] Green 1992:16231.
[86] Commonwealth of Australia 2000:11; Hutson 2000:14; Green 1992:16231.

United Kingdom will have to put its system of takeover regulation on a statutory basis, the primary fear of it's regulators has been partially assuaged.[89] Section 4(5) of the draft allows Member States to have an administrative process of takeover regulation, enabling the court in the United Kingdom to decline hearing actions brought during a bid.

It is submitted that it is evident, from the extended negotiation, investigation and conclusions reached by the member states of the European Union, that the mandatory bid is viewed as one of the most effective measures in the protection of minority shareholders in takeovers and mergers.

5.3.5 The European Code of Conduct Relating to Transactions in Transferable Securities

This code has as its fundamental objective the establishment of standards of ethical behavior to promote the effective functioning of the securities markets and the protection of public interest. The Code is based on a number of general principles of which one is equality of treatment of shareholders of the same class of securities, especially in the case of a transfer of shareholding effecting a shift in control in any company.[90]

Once again, the equal opportunity principle features prominently in shareholder protection in securities transactions.

5.3.6 The European Company Statute

The EEC Commission has published a proposal for a European Company Statute which would ultimately create a new form of business enterprise which will be governed in part by European law and in part by the law of the Member State in which it registers.[91]

Such a European Company would be formed by the merger of two or more public companies of different nationality within the European Union.[92] Regulation of these companies would rely heavily on directives already in force for a transnational regulatory component. In addition,

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[87] This agreement was reached in the Internal Market Council of Ministers on the 21ts of June 1999, but a final vote was delayed.
[88] Radcliffe 2000:40; Anonymous 2000:25.
[89] The chairman of the Takeover Panel has warned frequently of the risk of increased litigation and the ensuing difficulty, should takeover regulation be given a statutory basis, but has conceded that section 4 of the directive does offer some means of limiting the potential damage in this regard.
[90] Delport 1992:205.
[91] Morse 1999:13; Boyle and Sykes 1986:39.001.
[92] Morse 1999:13.

current drafts have evoked some negative comments on the efficacy of worker participation provisions, group formation and tax treatment.[93] More importantly, problems have already arisen for minority shareholders in groups of companies in the United Kingdom in the context of *ultra vires* and gratuitous payments.[94]

5.4 Minority shareholder protection and national regulation of takeovers and mergers

The mandatory bid as a primary means of minority shareholder protection in takeovers forms part of a number of the relevant in the Member States mentioned above:-

a) in the United Kingdom, the obligation to make a bid in incurred when a person obtains a 30% shareholding in the offeree company;

b) in Portugal this obligation is triggered by a mere 20% shareholding, while

c) in Italy it is only incurred one the offeror has obtained a 90% shareholding; finally

d) in Spain the obligation follows the acquisition of sufficient shares to alter the bylaws of the company.[95]

While the applicable regulations in the United Kingdom have already been reviewed in the discussion in the previous chapter, the applicable provisions in Germany, Austria and Sweden will now be studied.

5.4.1 Germany

Throughout the legislative process surrounding the promulgation of the thirteenth directive, Germany has actively opposed the obligation to introduce a mandatory bid rule into national law. It has consistently held that the remedies provided for the protection of minority shareholders is adequate and effective.[96]

5.4.1.1 Minority shareholder protection

Though there are few specified provisions aimed at the protection of minority shareholders, all shareholders must be treated equally in similar circumstances.[97] Provision is made for the

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[93] Farrar & Hannigan 1998:765 – 767.
[94] Farrar & hannigan 1998:765.
[95] Depser 1991:484.
[96] Andenas 1996:150.
[97] Aretz 1993:108.

statutory protection of minority shareholders in the German Joint Stock Corporation in the following manners:-[98]

a) 5% of the shareholders may call a general meeting and have items proposed by them included on the agenda;[99]

b) 10 % of the shareholders may approach the court for the appointment of auditors to conduct a special audit and investigate violations of the articles or the law;[100]

c) 10% of the shareholders can require claims to be brought against the members of the board where they believe breaches of duty have been committed by the management and can require the appointment of special representatives to assert the claim;[101]

d) a 10% minority has the right to demand a separate vote in respect of each member of the board where such vote is taken to approve the actions of members of the board;[102] and

e) an action is provided to remedy the detrimental effects of control exerted over a company by its majority shareholders by rendering such persons who exert such influence over the general meeting or management personally liable.[103]

In addition, any shareholder may require that management provide shareholders with information concerning the affairs of the company. Management may then only refuse if providing that information would constitute a criminal offence or the disclosure is likely to result in considerable harm to either the company or an affiliate. It is also possible to fuse on the grounds that the information required relates to the acceptability of balance sheet figures for tax purposes or that such information relates to a difference between the balance sheet value of an asset and the market value of that asset. Finally, information may also be refused if the information requested relates to the valuation or depreciation of asset value.[104]

No derivative action is available.[105] In addition, it may well be noted that, should the minority shareholders fail with their claim under paragraph 147, they are liable for the costs of the action, thus significantly inhibiting such actions.

5.4.1.2 The regulation of takeovers and mergers

Mergers are, in part, governed by the Transformations Act as promulgated on the 28th of October 1994. Transactions involving the takeover of an entire company is classified as such

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[98] Foster 1996:343 – 344.
[99] Aktiengesetz: par 122; Aretz 1993:107.
[100] Aktiengesetz: par 142 II.
[101] Aktiengesetz: par 147.
[102] Aktiengesetz: par 120.
[103] Aktiengesetz: par 117.
[104] Aretz 1993:108.
[105] Foster 1996:344.

and may be effected either by transferring the entire assets and liabilities in exchange for shareholding or through the formation of a new company.[106]

Germany also boasts a voluntary takeover code issued[107] by the Exchange Expert Commission of the Federal Ministry of Finance.[108] The Code is applicable only to stock corporations[109] or partnerships limited by shares[110] with a registered office in Germany and shares traded on a local stock exchange.[111]

This Code, too, is based on a number of general principles among which the following principles related to the principle of equality: within the scope of a tender offer, the offeror is required to treat all holders of securities of the same class equally[112] and both the offeror and the offeree must provide to all shareholders in the target company the same information for the evaluation of the offer.[113]

Articles 16 and 17 of the Code contain the provisions relevant to the mandatory offer. Any person who obtains control of a target corporation is required to immediately launch a mandatory offer to all other holders of securities. These provisions have recently[114] been amended to widen the definition of control from control determined with reference to voting rights, to control defined within the following parameters:-

a) control of a majority of the voting rights in the target company;
b) control based on agreements with other holders of securities of the target company entitling him/her to control of the voting rights;
c) the right to appoint or remove the majority of the members of the managing board of the target company; or
d) a share of the voting rights which would entitle the offeror in the circumstances of the preceding three shareholders meetings to at least three quarters of the voting capital present[115] and entitled to vote.[116]

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[106] Foster 1996:345.
[107] 14th July 1995.
[108] Hutson 2000:17.
[109] *Aktiengesellschaft.*
[110] *Kommanditgesellschaft auf Aktien.*
[111] Brown 1999:68.
[112] Takeover Code: Article 1.
[113] Brown 1999:69.
[114] 1 January 1998.
[115] This is viewed as a significant practical extension of the notion of control. In the two years preceding the introduction of this Code, the average attendance of shareholders at shareholders meetings of the 30 German Dax corporations came to no more than 63.35%. This attendance figure means that a shareholding as low as 35% would render a shareholder able to exercise control of the company in such a meeting. Brown 199971.
[116] Brown 1999:71.

No mandatory offer is required where control is obtained inadvertently and is then immediately relinquished or a person who holds those securities only temporarily for purposes of further placement obtains the required shareholding.[117] Neither is the mandatory offer required in instances where the acquisition of such shares is followed by a certain type of decision relating to the form of the company.

The price to be offered for the sale of shares should be in a reasonable relation to the highest consideration paid in the preceding three months. If the offeror purchased additional stock after obtaining control prior to the making of the mandatory offer, the consideration is fixed at the weighted average of the prices of those purchases to the extent that those prices were higher than the price mentioned above.[118]

The German code presents a more relaxed application of the rules applicable to the mandatory bid in that this obligation can be escaped through transaction structure, but even more so in the imprecise price requirement. This seems cold comfort for shareholders, but does present a significant step forward in a jurisdiction that had hitherto opposed the measure.

5.4.2 Sweden

The Swedish Industry and Commerce Stock Exchange has published a revised version of its recommendations on public tender offers on the Swedish Stock Market. These recommendations include rules on mandatory bids.[119]

One of the general principles contained in the recommendations is that all holders of shares with identical terms must be offered identical compensation per share. This is categorised as the principle of equal treatment of shareholders.[120]

Initially, the Swedish recommendations did not contain any provision for a mandatory bid. Now, the Swedish Industry and Stock Exchange Committee has decided that the time is ripe for the introduction of such measures and has proposed a mandatory bid. The obligation is triggered by obtaining a 40% stake in the voting rights of the company through purchases, subscriptions, conversions or other share acquisitions.

The acquisition of other securities such as convertible debentures will not trigger the bid until such a time as conversion has been completed and the prescribed percentage of voting rights

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[117] Brown 1999:71.
[118] Brown 1999:72.
[119] Skog 1999:14.

obtained and the Swedish Securities Council is granted the right to grant dispensation from these rules.

The concept of persons acting in concert is recognised in the calculation of voting rights holdings in the following manner by adding to the offeror's shareholding the voting rights held by companies in the same group as the shareholder, the offeror's spouse, live-in partner and minor children and others with whom the buyer has reached a agreement to vote in concert in order to secure a long-term influence on the management of the company.

The obligation to make the offer is incumbent upon the person who makes the critical acquisition of shares in the following terms: an offer must be made for all the shares and outstanding convertibles in the company and the terms must be adapted to those prevalent during the bid and may not be less favourable than any during the preceding six months. This obligation may be avoided by an offeror not able to meet the offer by selling down securities within a period of four weeks in order to lower the number of voting rights held to less than 40%.[121]

Though the shareholding level that would trigger the obligation to make the bid is slightly higher than in other jurisdiction, the novel extension of the concept of persons acting in concert and longer price maintenance period may well balance this disparity. This dispensation is notably favourable to minority shareholders and it is submitted that it offers sound protection against abuse.

5.4.3 Austria

In 1998 Austria enacted a takeover act[122] aimed at the regulation of public offers for shares in public limited companies listed on the Vienna Stock Exchange.[123] The Act is based on a number of general principles, amongst which the following general principle:-

> 'All holders of shares in the target company whose circumstances are the same must be treated equally unless otherwise provided in this Act.'[124]

As is the case in South African law, offerors may only make a takeover bid if they are convinced that they will be able to amass the necessary resources to effect complete

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[120] Skog 1999:14.
[121] Skog 1994:16.
[122] [1998] *Bundesgesetzblatt für die Republik Österreich* 1559 (14 August 1998).
[123] 1998 Takeover Act:Introduction.
[124] 1998 Takeover Act:s 3.

performance timeously.[125] A takeover bid, in turn, is defined as an offer for all of, or a part of, the shares in the offeree in return for either cash or securities.[126]

Austria has inserted an obligatory offer in its act, triggered by the acquisition of a controlling interest in the offeree company. Such a controlling interest is one which would enable the offeror to exercise a decisive influence over the company.[127] The act does not, however, stipulate a percentage shareholding that would trigger the obligation. In its stead, the act empowers the takeover panel[128] to issue regulations setting out detailed preconditions as to the existence of a controlling interest, with due consideration of the following factors:-

a) the size of the percentage of voting rights held required;
b) the spread of other shareholdings with voting rights
c) the equity capital with voting rights normally presented in general meeting; and
d) the provisions of the articles of association.[129]

These regulations must stipulate which percentage of voting rights attributable to voting stock an offeror must acquire to give rise to the assumption of a controlling interest, but it may be no less than 20%. This assumption is refutable upon presentation of proof of the fact that another shareholder or group of shareholders hold a bigger interest.[130]

As is the case in other jurisdictions, provision is made for persons acting in concert, whether such co-operation is based on membership of a group of companies or a contract or agreement of any nature.[131] The act, however, includes a number of novel exceptions. Stock acquired as a result of gifts between relatives, as a result of succession or as a result of an apportionment of assets pursuant to a divorce, dissolution or annulment of a marriage is excludes, as well as stock transferred between entities in which the same shareholders or their relatives hold a similar interest. Similarly, stock transferred to a private foundation of which the beneficiaries are the former shareholders or their relatives is also excluded.[132]

An offeror acquiring such a controlling interest must make an offer for all the shares in the company and must give 20 trading days' notice to the panel of that fact.[133] The obligatory offer price must correspond to the average price at which the stock traded during the preceding six months and may not be more than 15% lower than the highest consideration

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[125] 1998 Takeover Act:s 4.
[126] 1998 Takeover Act:s 1.
[127] 1998 Takeover Act:s 22.
[128] A takeover panel is instituted by the provisions of part 4 of the 1998 Takeover Act in section 28 to 35.
[129] 1998 Takeover Act:s 22(5).
[130] 1998 Takeover Act:s 22(5).
[131] 1998 Takeover Act:s 23(1).
[132] 1998 Takeover Act:s 24(1).
[133] 1998 Takeover Act:s 22(1).

paid by the offeror during the bid period.[134] This presents a significant departure from the principles applied in other jurisdictions. Companies can, however, exclude this percentage deviation in their articles of association.[135]

It is submitted that, especially, the supple formulation of control notions in this legislation present a commendable solution to some of the problems that may be posed by the mandatory bid obligation. The less stringent price guarantee is, however, not as favourable as may be and presents a deviation from the strict price equality guarantees offered by the bid obligation in other jurisdictions.

5.5 Conclusion

> 'No longer content to be on the outside looking in, minority shareholders in continental Europe are beginning to break down the door. ... [T]hey have seen their rights trampled upon, their profits plundered by secretive bosses and their bid-shareholder chums. Where once they would have yelped, but little more, disgruntled outsiders are now joining forces and calling their lawyers.'[136]

In a comment on a number of takeover bids in Europe in the early 1990's, the following shareholder positions were juxtapositioned: that of the French shareholder within whose country the mandatory offer is based on a two-tiered system[137] and that of the German minority shareholder who is left in the cold when control shifts hands, but is protected in some instances by a 5% vote-capping per shareholder.[138]

Since it has become evident that the introduction of the mandatory bid is imminent, members states, such as the ones described above, have taken steps to enact legislation and codes akin to that of the United Kingdom and South Africa, containing the only truly efficient means of protecting minority shareholders: the mandatory bid.

As is evident from the variant manners in which the member states examined above have chosen to introduce the mandatory bid, the level of protection can be significantly influenced by the level of shareholding at which the obligation is triggered. The higher the percentage shareholding required, the more exposed the remaining shareholders are, depending on the

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[134] 1998 Takeover Act:s 26(1).
[135] 1998 Takeover Act:s 27(1).
[136] Anonymous 1992:102.
[137] This two-tiered systems entails that any person acquiring a third of the voting stock of a company is entitled to launch a bid for at least another third, and that any person who acquires 50% or more of the voting stock in a company in one go, must bid for the remainder.

ownership structure of the company in question. This has been admirably addressed by the more supple suggestions on control contained in the Austrian legislation.

Once the issue of the level of shareholding has been addressed, it becomes evident that the concept of persons acting in concert who may already hold that percentage of shares needs refinement. While the United Kingdom has focussed on more formal and commercial definitions of the idea of action in concert, the other member states, and especially Sweden and Austria have developed novel and useful guidelines on transactions within families and constructive family units. It is submitted that this is a commendable notion, if suited to the corporate ownership structure in the relevant jurisdiction.

The construction surrounding the price to be paid is cause for greater concern. While the provisions in the United Kingdom and in South Africa have held firmly to the requirement that the price paid to minority shareholders who choose to leave the company be equal to the highest price paid in a preceding period of time, the lowering of this benchmark in both Germany and Austria is alarming.

The mandatory bid, however, comes in a number of guises, one of which is to be found in Australian company law, which boasts its own system of regulation and its own mechanisms for the protection of minority shareholders.

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[138] Anonymous 1999:102.

CHAPTER 6

AUSTRALIAN LAW

6.1 Introduction

The securities industry in Australia is regulated by legislation, rules adopted by the stock exchanges and the common law.[1] This chapter will focus on the protection of minority shareholders in Australian law as well as the regulatory regimes for take-overs. In this analysis, the Corporate Law Economic reform Programme, colloquially referred to as CLERP, will be reviewed in so far as substantial reforms have affected minority shareholders in take-overs and mergers.

The Australian compulsory acquisition provisions will also be studied and compared to the procedure in the United Kingdom.

Australia boasts a complicated federal system of corporate law. Though it appears as if the corporate law is contained in a national law, it is in fact a State law with a number of federalising features.[2] The Corporations law referred to below is not a single act but an act of each of the states[3] of the Commonwealth creating a national system of regulation which is supported by a number of mechanisms including:-

a) the Australian Securities and Investments Commission which assumes, as a national regulator, full responsibility for the regulation of companies;

b) federal administrative bodies such as the Commonwealth Ombudsman and the Administrative Appeals Tribunal; and

c) any amendments made to the Corporations Act of the Commonwealth automatically applies in each State, irrespective of whether that legislation is passed within a State.[4]

A number of other institutions were initially empowered to aid in this process, but have failed in the face of constitutional challenges to their validity.[5]

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[1] Santow 1980:1.
[2] Ramsay 2000.
[3] The main rationale for this construction is the fact that the Australian Constitution confers the power to regulate the incorporation of companies only on States and not on the Commonwealth government.
[4] Ramsay 2000.
[5] Most notably cross-vesting legislation enacted to give the Federal Court the power to hear matters arising under the State acts has been found unconstitutional along with the power of the Commonwealth Director of Public Prosecutions to appeal against sentences or findings in actions arising from the Corporations Act.

6.2 The protection of minority shareholders in Australian company law

The tension that may exist in any company between the minority shareholders and those who wield control of the company, is recognised in Australian law and a number of mechanisms have been developed in restriction of the powers of the majority shareholders.[6]

At Australian common law, shareholders need only exercise their powers *bona fide* for the benefit of the company.[7] Majority shareholders owe no duty to minority shareholders[8] and what little protection is afforded such minority shareholders is limited under the severe procedural limitations known as the rule in *Foss v Harbottle*.[9] As is the case in other jurisdictions, this rule is divided into two parts termed the 'internal management' and 'proper plaintiff' requirements respectively.[10] The internal management rule relates to the principle that a perceived wrong, which consists of an act the majority shareholders are actually entitled to commit, may be ratified by those shareholders in a meeting. In turn, the 'proper plaintiff' rule determines that, if an actual, unratifiable wrong was done to the company, the proper plaintiff to institute such action is the company.

Four exceptions to the rule in *Foss v Harbottle* are recognised in Australia:-

a) acts that are illegal or *ultra vires*;[11]

b) actions requiring more than a majority vote attempted through a majority vote;[12]

c) infringement of a personal right[13] of one of the shareholders; and

d) fraud on the minority, which has been interpreted in Australian law to include actions with the effect of discriminating between the majority shareholders and the minority shareholders so as to give the former an advantage of which the latter are deprived, including:-

   i) appropriation of the property of the company for the controllers;

   ii) ratification of the breach of a director's duty to act in good faith; and

   iii) expropriation of the shareholding of the minority.[14]

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[6] Mitchell 1994:92.
[7] Hill 1992:86.
[8] Mitchell 1994:92.
[9] (1843) 2 Hare 461, 67 ER 189.
[10] Kluver 1993:7; Redmond 1992:523; Dowse 1991:34,102; Afterman & Baxt 1975:521.
[11] Redmond 1992:529 – 530.
[12] Redmond 1992:528 – 529.
[13] Rights in this context include rights derived from the Corporations Act, rights in terms of a separate contract with the company and rights derived from the articles of association. See also Redmond 1992:529.

A further requirement is set for an action based on fraud on the minority, namely that the defrauders must have effective control of the company, either through their control of the board of directors or through control of the general meeting.[15] Fraud on the other hand, need not constitute dishonest or immoral behaviour. Such actions as issuing shares for an improper purpose has been held sufficient cause for succeeding with an action.

A possible fifth exception to the rule in *Foss v Harbottle* has been identified in cases based upon necessity and justice.[16] It has been suggested that this fifth exception to the rule be expanded as an alternative to the introduction of a statutory derivative action as discussed below.[17] A common law derivative action could then be allowed on the grounds of the considerations of justice and convenience and would not be limited in application as is the first four exceptions to the rule.[18]

The poor situation in which minority shareholders find themselves has been further aggravated by the refusal of the courts to interfere in the internal matters of a company. In fact, these decisions and rules such as the one in *Foss v Harbottle* has been described as a 'inherent pattern of bias against minority shareholders'.[19]

6.2.1 The common law derivative action

The common law derivative action has been described as an action whereby one or more of the shareholders bring action in the name of the company where the company improperly refuses or fails to pursue a cause of action.[20] Such an action may be brought in cases where the directors of the company involved are acting in abuse of their powers by knowingly or recklessly acting contrary to the law, as a result of which the company sustains a loss.

The implementation of the action is, however burdened by a number of factors. The possible cost that may be incurred by unsuccessful shareholders is detrimental to the efficacy of the remedy as, is the fact that the remedy is not available to an equitable owner of shares. Finally, the application of the action is hampered by the uncertainty inherent in the law of shareholder ratification.[21]

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[14] Teele 1995:329; Kluver 1993:8; Redmond 1992:528; Dowse 1991:34,103 – 34,105; Afterman & Baxt 1975:522.
[15] Dowse 1991:34,105.
[16] Teele 1995:329; Kluver 1993:8.
[17] See 5.1.2 below.
[18] Teele 1995:331.
[19] Hill 1992:88.
[20] Kluver 1993:8.
[21] Kluver 1993:9.

It is evident that this action in Australian law is much the same as the South African and United Kingdom actions. It is not an action designed for the take-over arena specifically and, given its implementation difficulty, not an effective remedy either.

6.2.2 The statutory derivative action

The Companies and Securities Law Review Committee proposed the introduction of a statutory derivative action into Australian Company Law in 1990.[22] This proposal was made in recognition of the fact that the existing legislation, at that stage, was inadequate to provide a method of enforcement where a company improperly refuses or fails to pursue a cause of action.[23]

The action, as proposed, would allow a shareholder, director or the Australian Securities Commission to commence proceedings on behalf of a company in respect of wrongs done to the company, where the company is unwilling or unable to do so. The introduction of such an action would remove the uncertainty surrounding the common law action and would provide the courts with a discretionary power to indemnify applicants and defendants out of company funds.[24] It has been fairly commented that:-

> 'It seems improper that a minority shareholder, initiating litigation for the company, should not be supported financially by the company, provided his actions are prudent and reasonable.'[25]

Pursuant to this, the Lavarch Committee[26] supported the introduction of such a remedy, mindful of the possible pitfalls:-

a) that the procedure may discourage the acceptance of directorships by able persons due to the general vulnerability of directors to such derivative suits;
b) the possibility of spurious shareholder litigation employing the derivative action; and
c) a proliferation of proceedings due to the proposed ability of the shareholders to obtain indemnification at the expense of the company.

Nonetheless, a Draft Bill on the introduction of a statutory derivative action was released in 1995.[27] One of the primary changes introduced by means of the Corporate Law Economic

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[22] Report no 12 E*nforcement of the duties of directors and officers of a company by means of a statutory derivative action* December 1990.
[23] Kluver 1993:7.
[24] Teele 1995:329.
[25] Dowse 1991:34,109.
[26] Report of the House of Representatives Standing Committee on Legal and Constitutional Affairs *Corporate practices and the rights of shareholders* November 1991.

Reform Program Act,[28] which commenced on the 13th of March 2000, is the introduction of a statutory derivative action and the abolition of the common law rules relating to *Foss v Harbottle.*[29]

This action is contained in section 236 of the Corporations Law, as amended, headed 'Bringing, intervening in, proceedings on behalf of a company.' The provision allows any member, former member, officer or former officer of the company to bring proceedings on behalf of the company or intervene on behalf of the company for the purpose of taking responsibility on behalf of the company for those proceedings. No other requirements or circumstances are set out.

The court is then empowered to make any orders and give any directions that it considers appropriate.[30] It may also make any order it considers appropriate relating to costs.[31]

The possible application of this action is so broad as to facilitate almost any shareholder action on any grounds. It presents a significant victory for shareholders who suffer under corporate mismanagement, but does little to protect the minority shareholders in a take-over or merger. The purpose of this provision is clearly to empower shareholders to safeguard the affairs of the company – not their own affairs. In take-overs, it is the shareholder that is at risk and not necessarily the company.

6.2.3 Oppression of minority shareholders: the statutory remedy

The so-called oppression remedy was introduced into Australian Company Law in various provisions after 1947.[32] These provisions included section 94 of the Companies Act 1958 (Victoria), section 379A of the Queensland Companies Act 1931 and section 128 of the Companies Act 1959 of Tasmania. Section 186 of the 1961 Uniform Australian Companies Act made provision for the appointment of inspectors in the following terms:-

> 'Any member of a company who complains that the affairs of the company are being conducted in a manner oppressive to one or more of the members (including himself) may, or, following on a report by an inspector under this Act, the Minister may apply to the Court for an order under this section.'

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[27] Baxt 1996:312.
[28] Corporate Law Economic Reform Programme Act 156 of 1999.
[29] Ramsay 2000. Section 236(3) is worded 'The right of a person at general law to bring, or intervene in, proceedings on behalf of a company is abolished.'
[30] Corporations Law: section 241(1).
[31] Corporations Law: section 242.
[32] Hill 1992:92.

The possible orders enunciated by the legislature in terms of this section include winding up the company on the grounds that it is just and equitable to do so. In fact, once oppression is satisfactorily shown, the court is empowered to give almost any order required to put an end to the oppression.[33] Winding up, though, is viewed as an extreme measure.[34]

One of the best examples of ingenious orders aimed at putting oppression to an end, frequently referred to in Australian literature on the subject, may be found in the court's judgment in the case of *Re HR Harmer Ltd*[35] where the oppressive majority shareholder was banned from participation in the management of the company and reduced to nominal president for life.

Prior to the implementation of CLERP, the oppression provision was contained in section 260 of the Corporations Law.[36] Though substantially the same as the former provision, it accommodated better regulation of squeeze-outs in small private companies involving the removal of the petitioner from a management position in the company. In addition, the term 'oppressive' was previously interpreted restrictively and a popular definition required that the conduct should be burdensome, harsh and wrongful, it should lack the degree of probity which other members of the company are entitled to expect and it should involve some overbearing act or behaviour by the oppressor.

The amended section 260 was extended and made the following kinds of actions impugnable under the oppression provision:-

a) oppressive behaviour;
b) unfairly prejudicial conduct to certain members;
c) conduct unfairly discriminatory against a member or members; or
d) actions contrary to the interests of the members as a whole. [37]

Provision had been made to dispose of the requirement that the behaviour involved has to be 'wrongful' in the sense that it was illegal. In addition the previous qualification that the relevant conduct excluded an isolated act, a course of conduct which was now over or threatened conduct had been refined to make provisions for the application of the relevant provisions to cases involving an act,[38] omission, proposed act or omission by or on behalf of the company or certain resolutions.

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[33] Afterman & Baxt 1975:556.
[34] Hill 1992:88.
[35] [1959] 1 W.L.R. 62.
[36] Mitchell 1994:92.
[37] Hill 1992:94.
[38] The discretion of the court will only be invoked in cases where the single past act would need to be so serious as to equate a continuing present state of affairs.

Typical oppressive situations targeted by the provisions of this section include:-

a) those in which directors appointment themselves to paid posts within the company at excessive rates of remuneration at the cost of the shareholders' dividends;

b) the issue of shares to directors on advantageous terms;

c) the passing of non-cumulative preference dividends on shares held by the minority; and

d) the obdurate harassment of shareholders to remove them from the company at low cost.[39]

As is the case in South African law, *locus standi* to bring an action is dependant on the petitioner's membership of the company involved. It is sufficient that the person bringing the action is a member of the company at the time of bringing the action.[40] The Australian Securities Commission is also empowered to bring such an action.[41]

The amended section 260 has been described as a powerful remedial tool.[42] The following judicial comment has been elicited in point:-

> 'The provisions contained in s 260 of the Corporations Law has been drafted in wide form in order to accommodate the almost limitless varieties of oppressive behaviour possible and the need for the court to have an appropriately extensive discretionary power to effect justice in the particular circumstances of individual cases.'[43]

The court is granted the power to direct that the company institute, prosecute, defend or discontinue specified proceedings, or authorising a member or members of the company to do so on behalf of the company.[44] Provision is also made for the issuing of orders that the company be wound up, regulating the future conduct of the affairs of the company, for the purchase of the shares of some members by other members, for the purchase by the company of its own shares or restraining persons from engaging in specified conduct.[45]

Despite this, substantial criticism has been levied against section 260 as a derivative remedy. It was argued that applicants are limited to registered shareholders and the Australian Securities Commission, thereby excluding directors and beneficial shareholders and that the content of the

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[39] Dowse 1991:34,122 – 34,123.
[40] Kluver 1993:9.
[41] Dowse 1991:34,124.
[42] Kluver 1993:9.
[43] *Re Bodaibo Pty Ltd* (1992) A.C.S.R. 509:539.
[44] Kluver 1993:10; Dowse 1991:34,107.
[45] Dowse 1991:34,124.

qualifying term 'contrary to the interests of the members as a whole' is so uncertain as to restrict the application of the remedy. In addition, no explicit provision was made for costs, the greatest inhibitor to shareholder litigation and the standard of proof required of shareholders was too onerous to make the remedy effective. Finally, no indication was given of the possible role of the general meeting.[46]

The provisions relating to this remedy are now contained in section 232 which allows the court to make an order under section 233 if the conduct of a company's affairs, an actual or proposed act or omission by or on behalf of the company or a resolution is either contrary to the interests of the members as a whole or oppressive to, unfairly prejudicial to or unfairly discriminatory against a member or members in that capacity or any other capacity.

The way in which the action is formulated, would allow members of the company to institute proceedings against other members of the company for proposed actions or actions that would impact on their rights.[47]

It is quite clear that the remedy has been significantly extended so as to render it more efficient in the protection of all shareholders. It even gives members of the company a right of action against other members of the company – a right that can significantly improve the position of shareholders in take-overs and mergers as well. Despite this, it was considered necessary to implement the mandatory bid as well in order to protect minority shareholders.

6.2.4 Personal actions

Individual shareholders in a company may institute civil proceedings based on wrongs done by the directors of a company based on infringements of his/her personal rights. Such rights may originate in the articles of the company or in relevant legislation and include:-

a) voting;

b) receiving dividends declared ;

c) getting proper notice of meetings;

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[46] Kluver 1993:10-11.

[47] Corporations Law: section 232. This section has the following wording: 'The court may make an order under section 233 if:

(a) the conduct of a company's affairs; or

(b) an actual or proposed act or omission by or on behalf of a company; or

(c) a resolution, or a proposed resolution, of members or a class of members of a company; is either:

(d) contrary to the interests of the company as a whole; or

(e) oppressive to, unfairly prejudicial to, or unfairly discriminatory against, a member or members whether in that capacity or in any other capacity.

d) preventing improper alterations of the articles;

e) having shares issued only in good faith; and

f) not having shares improperly diluted.[48]

Once again, the personal action substantially reflects its counterparts in other jurisdiction. It is consequently submitted that this remedy does not adequately address the protective needs of minority shareholders in affected transactions either.

6.2.5 Minority protection: Varying structures of authority within the company

A number of ways exist in which members of a company may make provision for more adequate protection of minority shareholders through varying the authority structure within the company. These methods may include shareholder agreements incorporating certain relevant provisions for the protection of minority shareholders, rights of veto for minorities or voting trusts. It is also possible to structure classes of shares in such a manner so as to afford equal control over the affairs of the company. As is the case in America, it is also possible to build supermajority voting requirements and weighted voting into the company's management structure.[49]

Australian company law also contains general shareholder safeguards like the right of members to inspect the books of the company.[50]

As is the case in American law, internal arrangements may provide more adequate protection than statutory measures. The only drawback to the provision of such safeguards for the minority is that it is dependent on approval by the majority.

6.3 Takeovers and mergers

The Eggleston Committee[51] enunciated the (then) Australian view on the regulation of takeovers and mergers in the following terms:-

> 'There appears to be general agreement that some regulation of takeovers is necessary to ensure fair treatment of shareholders.'[52]

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[48] Dowse 1991:34,102.
[49] Hill 1992:89.
[50] Paterson and Tez 2000:23.
[51] The Company Law Advisory Committee is colloquially referred to as the Eggleston Committee in honour of its chairman.
[52] 2nd Interim Report of the Company Law Advisory Committee, 1969.

This consideration is still one of the primary motivations for the regulation of takeovers, along with ensuring that shareholders have an opportunity to sell on equal terms.[53]

Prior to the enactment of the Corporations Law, takeovers were governed by the provisions of the uniform takeover code as contained in the Uniform Companies Act.[54] Subsequently a Companies (Acquisitions of shares) Act was enacted in 1980 to contain such measures. The provisions relating to takeover activity, are contained in Chapter 6 'Acquisition of shares' of the Corporations Law,[55] and the Australian Securities Commission Act.[56]

Acquisitions of corporate control may be effected in a variety of ways in Australian Law, some of which are held in common with methods employed in South African company law. Such methods include:-

a) a sale of shares agreement;
b) a take-over scheme or take-over announcement initiated by the acquirer;
c) a selective reduction of capital or a selective buy-back of shares; and
d) a scheme of arrangement initiated by the target company.[57]

In Australian law, however, a positive distinction is made between members' and creditors' schemes of arrangement. A members' scheme of arrangement is typically utilised to secure an agreement between a company and its members to vary the contractual rights of the shareholders. A creditors' scheme of arrangement, on the other hand, is applied to secure an agreement between the company and its creditors for the variation of their contractual rights.[58] The acquisition of shares in terms of a take-over scheme is condoned in section 616 of the Corporations Law as one of the exceptions to the general restrictions on the acquisition of shares contained in section 615.[59]

A take-over scheme is a system of formal take-over offers governed as to the form of the offers, statements to be exchanged by the offeror and the offeree and the manner in which the target company may approve the take-over offer.[60] Such an offer must be made for all the shares of one class held by the offeree[61] and the offers must be the same for each shareholder.[62]

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[53] Dowse 1991:L 6021.
[54] Austin 1993:144; Afterman & Baxt 1975:619.
[55] Dowse 1991:62,101.
[56] Baxt et al 1996:3.
[57] Colla 1998:365 – 366.
[58] Colla 1998:367.
[59] Dowse 1991:62,103.
[60] Dowse 1991:L 6022.
[61] Corporations Law: s 635.
[62] Corporations Law: s 636.

Unlike the provisions contained in the South African Companies Act,[63] no provision is made for the regulation of specific affected transactions as it relates to the intention of the offeror to gain control of the target company. In its stead, provision is made for full take-over schemes[64] and partial take-over schemes.[65]

6.4 The Corporate Law Economic Reform Programme

Australia launched its Corporate Law Economic Reform Programme in 1997.[66] The main aims of this programme include promoting business development through reforming key areas of corporate and business regulations.[67] The new policy framework has been developed to contribute to the efficiency of the economy while maintaining investor protection and market integrity. One of these changes include improving takeovers regulation to promote a more competitive market for corporate control. Paper number 4 on the proposals for takeovers, styled: *Corporate Control: a better environment for productive investment*, was published for comment in 1997.[68] The proposed reform of take-over regulation was designed to provide business with appropriate arrangements for the regulation of changes of corporate control and achieve an appropriate balance between facilitating efficient money management and control of organisations while insuring a sound investor protection regime. [69]

The process ultimately led to the promulgation of the Corporate Law Economic Reform Program Act 1999. The major parts of the act commenced operation on 13 March 2000.

After amendment by the 1999 CLERP Act, the Corporations Law prohibits the acquisition of shares beyond a holding of 20% of the total voting shares in a company, subject to a number of

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[63] Companies Act 61/1973.
[64] A take-over scheme under which each take-over offer relates to all the shares in the target company in the relevant class.
[65] A take-over scheme under which each take-over offer relates to a proportion of the shares in the target company in the relevant class, being a proportion that is the same in respect of each offer.
[66] This reform programme was preceded by the Corporate Law Simplification Task Force who set their agenda for the reform of take-over regulation in the following manner:-

a) broad ranging and important changes to the 'relevant interest' and 'entitlement' rules;
b) the removal of the 'checklist' approach to the content of take-over documentation;
c) the amendment of liability provisions; and
d) a substantial revamp of the compulsory acquisition sections contained in the Corporations Law.

This programme was, however replaced by the Corporate Law Economic Reform Program pursuant to a change in Government. See Cajella 1997:208 and Mannolini 1996:471.
[67] CLERP Policy Reform 1997:iii; Black et al 1998:1.
[68] Black et al 1998:2.
[69] CLERP Paper No 4:5.

exceptions. The most important of these exceptions is the acquisition of shares under a takeover offer which will have the effect that corporate control is also acquired after the offer is made.[70]

The key reforms enacted in the area of takeovers include the introduction of a mandatory bid rule and the amendment of the compulsory acquisition procedure.[71]

6.5 The principle of equal opportunity

6.5.1 The scope and application of the principle of equal opportunity

In its Second Interim Report published in 1969, the Eggleston Committee identified four principles that should govern any take-over regulation, known as the Eggleston Principles. Firstly, it was recommended that the identity of the offeror be known to the shareholders and directors and that a reasonable time should be afforded to the shareholders and directors to consider the proposals. In addition, it was recommended that the information necessary to form a judgment on the merits of the proposal be available to them and that so far as is practicable, each shareholder should have an equal opportunity to participate in the benefits offered.[72]

The principles were adopted, in an extended form, by the predecessor of the Australian Securities Commission, the NCSC, where the objectives applied by the NCSC in the exercise of its powers were set out to include:-

a) that fair dealing and equity exists between all members of a company involved in a takeover bid and that, as far as is practicable, each member has:
   i) equal access to information;
   ii) equal opportunity to deal in the market; and
   iii) equal opportunity to participate in any benefits accruing to a member under a bid;
b) that the premium for control of a company is shared by all members.[73]

These principles were first uniformly enacted into the substantive law in the Companies (Acquisition of shares) Act of 1980. In the ensuing Corporations Act the principles were likewise retained and enacted in sections 731 and 732 which related to the exercise of its powers by the Australian Securities Commission.[74]

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[70] Commonwealth of Australia 2000:5.
[71] Black et al 1998:3.
[72] Calleja 1997:209; Mannolini 1996:471; Dowse 1991:62,101; Afterman & Baxt 1975:619.
[73] Dowse 1991:62,102.
[74] Mannolini 1996:472.

The equality principle as contained in the current Corporations Law is construed to be found in three elements:

a) the rule that all shareholders in the target must receive identical offers to purchase all or an equal proportion of their shares;[75]

b) the provisions of section 698 of the Corporations Law as it relates to the prohibition on an offer of collateral benefit to specific shareholders; and

c) the operation of the concepts of 'relevant interest' associate' and 'entitlement'.[76]

6.5.2 The principle of equal opportunity under the Corporate Law and Economic Reform Programme

Investor confidence was identified in the Corporate Law and Economic Reform Programme as one of the crucial features of efficient financial markets. Direct capital market investment is less likely when potential investors have the perception that they are likely to receive lower returns because of weak bargaining positions. This will, for example, be the position when they are left as a minority following a change of corporate control. [77] Consequently provision for an opportunity to sell out where control of the company changes, it was argued, encourages investment.

The application of the equal opportunity principle ensures that each shareholder has an equal opportunity to participate in the benefits offered under a takeover bid. More accurately, it entails that any premium offered by a bidder in order to obtain control of a company, must be offered to all shareholders.

Though the criticism levied against the application of this rule is recognised, [78] the law reform program recognises the dichotomy:- the promotion of economic efficiency against the encouragement of investment through shareholder protection. [79]

In cognisance of the increased cost of takeovers as a result of the implementation of this rule it is accepted that either the total consideration paid in a takeover bid will be greatly increased, or the premium paid for control across the board, lower. Despite this, the potential benefits of equal opportunity exceeds the cost and the first proposal on takeover regulation is:-

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[75] See also the discussion in Little 1997:10 on the sharing of control premiums as contained in the equality provisions.
[76] Mannolini 1996:473.
[77] CLERP Paper No 4: 11.
[78] See the discussion at 3.4 above.

"The equal opportunity principle should be retained. This would ensure that all shareholders of a target company have reasonable and equal opportunities to participate in any benefits under a change in corporate control. [80]"

As a consequence of this recommendation, the principle of equal opportunity was formulated in the following terms in section 602 'Purposes of Chapter' of the CLERP Bill 1998 under the heading of Chapter 6 'Takeovers':-

'(c) as far as is practicable, the holders of the relevant class of voting shares or interests all have a reasonable and equal opportunity to participate in any benefits accruing to the holders through any proposal under which a person would acquire a substantial interest in the company, body or scheme;'

On the 7th of May 2000, the Australian Securities and Investment Commission released a policy proposal concerning the minimum bid price principle now contained in section 621(3) and 621(4) of the Corporations Law.[81] It is now suggested that offeror be allowed to value the shares five days prior to making the offer. This valuation will then be included in the statement which the offeror is required to lodge with ASIC.[82]

6.6 The Mandatory Bid

Initial proposals under the Corporate Law and Economic Reform Programme for the reform of take-over regulation in Australia included a proposal that, in order to facilitate a more competitive market for corporate control, a bidder will be able to exceed the take-over threshold before being obliged to make a take-over offer, subject to the following conditions:-

a) the bidder must start from below the 20 per cent threshold with only one acquisition being allowed before the so-called mandatory bid requirement will be triggered by an agreement to sell;

b) a bidder must disclose to the selling shareholder that the mandatory bid requirement will be triggered by an agreement to sell;

c) a bid for all the outstanding shares in the target must be announced immediately following the bid-agreement;

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[79] CLERP Paper No 4:11.
[80] CLERP Paper No 4:17.
[81] These sections were inserted by the Corporate Law Economic Reform Programme Act of 1999 and came into operation on the 13th of March 2000.
[82] Cockburn 2000:11-12.

d) the bid must be for a share price at least equivalent to the highest price paid by the bidder in the last four months;

e) target shareholders must be provided with the report of an independent expert;

f) the bidder must not exercise control of the company prior to making the mandatory bid;

g) the bidder must prove in its statement that it is able to afford the full bid;

h) the bid must be unconditional and for cash only; and

i) no shares may be issued for a certain period pursuant to the announcement of a take-over without shareholder approval.[83]

The mandatory bid as considered by the Australian Law Reformers entails the making of an offer once a certain level of shareholding is reached.[84] While there is some recognition for the fact that such a mandatory bid could preclude any rival offers, a number of benefits are advanced. The mandatory bid increases certainty as to the outcome of a bid. Where potential bidders may otherwise be discouraged due the uncertainty or the risk of becoming involved in a bidding war, the mandatory bid recognises pre-bid agreements. Lower bid costs are brought about through the possible preclusion of rival bidding and the mandatory offer makes for a smoother bidding process.[85]

As a result proposal number 2 on the introduction on a mandatory bid rule was introduced in the following terms

> "Changes in corporate control could be facilitated by allowing acquisitions which would exceed the statutory threshold provided that the acquisition was immediately followed by the announcement of a full takeover bid. This would provide market participants with an additional mechanism to acquire and relinquish corporate control. The government will consider whether a mandatory bid rule should be introduced in light of comment on this issue."

Such a mandatory bid would have to be considered within the principle of equal opportunity and would offer shareholders a fair opportunity to exit the company completely.

Proposal number three for the contents of such a mandatory bid rule recommended that certain conditions apply. A bid for all the outstanding shares in the target must be announced immediately following the agreement which takes the bidder above the statutory threshold, and the bid must be for an amount at least equivalent to the highest price paid by the bidder in the last

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[83] Commonwealth of Australia 2000:2; Fong, Ramsay & Boros 1998.
[84] The level of shareholding proposed in this manner is 30% compared to the current South African level of 35% as discussed above.
[85] CLERP Paper No 4: 22.

for month: the bid must be for cash or, if scrip is offered, there must be a cash alternative of equivalent value. Finally, it was recommended that the bid must be unconditional and that a person under an obligation to make a bid could be relieved from that obligation in exceptional circumstances by the panel.[86]

The following provisions relating to the mandatory bid were taken up in the CLERP Bill 1998 as one of the acquisitions exempt from the prohibition on the purchase of shares contained in section 606:-

> 'An acquisition that occurs in, or results from, the following sets of circumstances:
>
> a) a person (the acquirer) acquires a relevant interest in securities of a body corporate; and
>
> b) those securities were held, immediately before the acquisition, by a particular persons or by particular persons jointly (The prior holder or holders); and
>
> c) the acquirer does not, at the same time as the acquisition referred to in paragraph (a), acquire a relevant interest in the securities of the body held by someone other than the prior holder or holders; and
>
> d) immediately before the acquisition, the voting power of the acquirer in the body corporate is below 20%; and
>
> e) the acquisition is immediately followed by a public proposal by the acquirer, or an associate, to make an unconditional take-over bid for all the securities in the class to which the securities belong; and
>
> f) before the acquisition occurred, the prior holder or holders were informed that the acquisition would lead to that take-over bid.'[87]

It is clear from the wording and placement of the mandatory bid that it is not the same construction that can be found in the jurisdictions studied thus far. It is not an obligation triggered by a certain shareholding. It is rather an alternative method of achieving a take-over that can be selected by the potential bidder in planning a take-over under the proposed CLERP reforms as they relate to take-overs. It is not an occurrence in a take-over bid, but a supplementary means of obtaining significant shareholding in the target company. This is supported by the fact that it is possible to withdraw a mandatory bid with the consent of ASIC in certain circumstances.[88]

If this exception to the prohibition on the acquisition of shares applies to a company, three requirements must be met. The person who proposes to make a take-over bid for the relevant

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[86] CLERP Paper No 4: 25.
[87] CLERP Bill 1998: s 611.
[88] CLERP Bill 1998:s 652C(2); Black 1998:80.

securities must give notice of the proposed bid to the relevant securities exchange, or the Australian Securities and Investments Commission (ASIC). The votes attached to the securities so to be acquired may not be exercised by any person until the offer period starts or the persons and his/her associates have no relevant interests in the securities. Finally, if the target is a company or a body, the target may, from the time of the acquisition until the end of the bid period, issue or agree to issue securities, declare a dividend, or pay a dividend that is not declared, only when authorised to do so by a resolution passed in general meeting.[89]

In formulating an offer under Part 6.4 of the 1998 CLERP Bill, an offeror is required to include an offer of a cash sum for the securities that stand to be acquired in a so-called off-market mandatory bid, but may include other forms of consideration, such as securities.[90] The value of this consideration, whether in cash or securities must equal or exceed the maximum price paid over the preceding four months.

The mandatory bid provisions were removed from the Bill in the process of parliamentary debates and were not contained in the Corporate Law Economic Reform Program Act 1999.[91] The Parliamentary Joint Statutory Committee on Corporations and Securities[92] held hearings on the mandatory bid rule in March 2000.[93]

Subsequent to this, the Committee issued a report on the mandatory bid rule recommending that the Corporations Law be amended to include a mandatory bid rule on the same terms as proposed in the CLERP Bill.[94] On 9 November 2000, the Government released its response to the Report of the Parliamentary Joint Committee. Government now supports the recommendation that the mandatory bid as proposed in the CLERP Bill should be enacted. It does so, especially in the belief that this mechanism provides protection for minority shareholders.

These mandatory bid provisions afford the bidder a number of advantages. By giving potential bidders the choice of which take-over method to employ, such bidders are more likely to succeed resulting in the improved utilisation of assets and it ensures that all the shareholders in a target company have an opportunity to sell their shares at a fair price and benefit from the premium a bidder places on those securities.[95]

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[89] CLERP Bill 1998: s 614(1); Black et al 1998:79 – 80.
[90] CLERP Bill 1998:s 621(2); Black et al 1998:80.
[91] Commonwealth of Australia 2000:4.
[92] In terms of section 243 of the Australian Securities and Investments Commission Act 1989 the duties of this committee include enquiries into and reports on the operation of any national scheme law or any other law of the Commonwealth.
[93] Ramsay 2000.
[94] Commonwealth of Australia 2000:25; Anonymous 2000:3.
[95] Fong, Ramsay & Boros 1998.

In addition, some of the provisions relating to mandatory offers are specifically aimed at the protection of minority shareholders such as those designed to comply with the principle of equal opportunity, namely that all shareholders be given an opportunity to exit the target company at a fair price.

The threshold aside, one of the primary differences between the rule in the United Kingdom and the rule proposed in Australia is that the mandatory bid under City Code is conditional upon the acceptance of the offer by the holders of half the share capital.[96] Another significant difference is that the offer in the United Kingdom may be for cash only while, in Australia, the offer may be for cash of shares or a combination.[97] The significance is that a cash-only offer allows a sure exit from the company, thereby achieving effective minority shareholder protection. An offer for shares will have the effect that there is no opt-out for the minority shareholder.

The difference in threshold too, is deliberate. Whereas most other jurisdiction which have enacted a mandatory bid rule have enacted a threshold reflective of control, Australia elected for a lower threshold reflecting not effective control, but a level of shareholding reflecting significant influence and pressure.[98]

6.7 Compulsory Acquisitions

6.7.1 Compulsory acquisition under former Australian law

Provisions relating to the compulsory acquisition of dissenting shareholders where the majority shareholder already holds nine tenths of the shareholding in a company, has been said to be designed to overcome what in essence may involve the oppression of the majority by a small minority.[99]

A major objective of the law relating to the compulsory acquisition of the shares of a dissenting minority should be to balance the interests of the majority and the minority while ensuring that no fraud is committed on the minority and the will of the majority is not thwarted by the will of a 'bloody minded minority.'[100]

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[96] Commonwealth of Australia 2000:8.
[97] Commonwealth of Australia 2000:9.
[98] Commonwealth of Australia 2000:24.
[99] Digby 1992:106.
[100] Spender 1993:84.

It has also been noted that the title 'compulsory acquisition' immediately connotes negative inferences of the deprivation of property rights while the courts in Australia have always refrained from embracing any principle that these provisions amount to an unreasonable interference with the rights of individual ownership.[101]

There are several important advantages to be gained from achieving total control of a company, among which;-

a) the ability to transfer tax losses between companies in the same group;
b) a reduction in fiduciary related monitoring costs;
c) a cost reduction in the administration of a public company; and
d) the protection of confidential business plans and product developments.[102]

In recognition of this, Australian law, too, boasts a compulsory acquisition procedure.

6.7.1.1 The exception to the rule

Section 615 of the Corporations Law as it stood prior to the implementation of CLERP, placed a restriction on the acquisition of voting shares that would entitle the purchaser to a greater percentage of the voting shares than is prescribed. This prescribed percentage was set at 20 per cent and any person holding between 20 and 90 per cent of voting shares was restricted from acquiring any further voting shares.

As has been explained, this general rule is subject to several exceptions, of which one is if those shares are purchased under a take-over scheme.

Prior to the implementation of CLERP, The Australian Corporations Law contained provisions for the compulsory acquisition of securities when an offerer holds 90% of the shares in that company, provided that 75% of the shares were acquired during the bid.[103] The offeror who becomes eligible to compusorily acquire the shares of the remaining shareholders must give notice that it will proceed to do so to the Stock Exchange and to all remaining shareholders[104] of its desire to acquire outstanding shares within two months after the expiration of the offer period.[105] The offeror could also elect not to proceed with the compulsory acquisition, and must then give notice of that decision to the home exchange of the target company.

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[101] Digby 1992:105.
[102] Digby 1992:107 – 108.
[103] Corporations Law: s 701 (2) (c)
[104] As is the case in South Africa, the notice must be in a prescribed from, in this instance For 602A.

6.7.1.2 *Dissenting shareholders*

As is the case in South Africa, those shareholders who wish to escape expropriation could apply to the court to exercise its discretion to order that the acquisitions not occur.[106] Contrary to the situation in South Africa, however, the Australian Corporations Law made provision for certain procedures which may improve the position of the dissenting shareholder.

Within a month after an offeror had given notice of the compulsory acquisition, any dissenting shareholder could require that the offeror provide him/her with a statement of the names and addresses of all the dissenting shareholders, by means of a written notice. The offeror was then obliged to do so as soon as possible.[107]

As is the case in other jurisdictions, dissenting shareholders could then apply to the Supreme Court for an order that he/she is not compelled to sell their shares.

Similarly, the dissenting shareholders bore the onus of proving that the offer is not fair, particularly in view of the fact that it has been accepted by so many of the shareholders. A scheme can be considered unfair if one of the following factors are present:-

a) any element of impropriety, cheating or deception;
b) any attempt made by the offeror to exercise control of the target company prior to the take-over offer which has the effect of reducing the value of the shareholding of the minority shareholders;
c) materially misleading statements on which the majority shareholders may have based their decision to sell their shares;
d) evidence that the advice on which the board of the target company based their recommendation in favour of the acceptance of the bid was fundamentally flawed; or
e) evidence that the consideration offered in return for the shares was unfairly low.[108]

6.7.1.3 *The terms of the compulsory acquisition and the expert's report*

The terms of the bid are exactly applicable to the compulsory acquisition. This relates to not only equality of opportunity, but also to equality of consideration.[109]

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[105] Corporations Law: s 701 (2).
[106] Corporations Law: s 701(6).
[107] Corporations Law: s 701(9).
[108] Spender 1993:99.
[109] Dowse 1991:64,184. This has been retained and the provisions are now contained in section 662 A of the Corporations Law.

The holders of such securities may also compel the offeror to acquire their shareholding[110] in order to prevent the lock-in of the holders of these securities.[111] These securities must be acquired at the take-over offer price, save in instances where the offeror wishes to nominate the terms on which it is prepared to acquire the relevant securities. In such instances, its notice must be accompanied by an expert's report in which the expert states an opinion on whether or not the terms so offered are fair and reasonable.

Such a report should include:-

a) particulars of any relationship the expert may have with the offeror or the target company;
b) particulars of any pecuniary interest of the expert that may reasonably be regarded as being capable of affecting the experts ability to give an unbiased opinion; and
c) particulars of any fee received in relation to the report.[112]

Provision is also made for a follow-up to a successful formal take-over in cases where the offeror held at least ten per cent of the shareholding in the target company prior to the take-over, if the offeror has acquired three-quarters of the remaining shares or three quarters of the remaining shares have changed hands.[113]

6.7.1.4 A case in point

The recent judgment delivered by the Federal Court of Australia in the case of *DB Management (Pty) Ltd v Australian Securities and Investment Commission, Southcorp Wines Pty Ltd and Winpar Holdings Ltd*[114] provides a case in point of the conflicting principles at play in the compulsory acquisition of the shares of minority shareholders.

Pursuant to a successful take-over offer by the first respondent, it embarked upon the process of the compulsory acquisition of the remaining shares in the target company. The applicant had held options in the target company and exercised those options, after the completion of the take-over, to acquire shares in the target company. The respondent subsequently applied for a declaration enabling to acquire those shares also which was granted, conditional upon fulfilling the requirements that notice be given and that the notice be accompanied by an expert's report.

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[110] Corporations Law: s 662 A.
[111] Dowse 1991: 64,186.
[112] Dowse 1991: 64,188. These principles too, have been retained.
[113] Digby 1992:111.
[114] [1999] FCA 293.

The applicant applied for a declaration that it not be compelled to sell its shares, which was granted by the Administrative Appeals Tribunal. On appeal, it was held, it is submitted correctly, that the tribunal, *inter alia*, did not have the authority to make the declaration.

The joint judgment of the majority was founded on the presumption that legislation is not intended to interfere with vested proprietary rights and the proposition that an express reference to one matter indicates that other matters are excluded. These principles were applied to the following evaluation of the compulsory acquisition provisions:-

a) the express provisions for the compulsory acquisition of outstanding shares;
b) the absence of any provision relating to shares which were not the subject of the original offer; and
c) the omission in the provisions dealing with options to provide for the compulsory acquisition of options at the suit of an offeror.

The dissenting judgment, in turn, was founded on the policy underlying the compulsory acquisition provision and, as the policy related to the facts;-

a) that it facilitated the acquisition of shares where a high level of acceptance of a take-over offer had been achieved, as was the case; and
b) that safeguards had been provided in the form of the provision of an expert's report and in the preservation of the power of the court to intervene.

This judgment addresses all of the conflicting principles that may be found in the compulsory acquisition procedure. It is, however submitted, that the dissenting judgment is to be favoured when considering the purpose of the provisions as outlined at 6.7.1.

6.7.2 Compulsory acquisition under the Corporate Law Economic Reform Programme

Initial proposals under the Corporate Law Economic Reform Programme for the reform of take-over regulation in Australia included a proposal that, in order to facilitate the more efficient use of investment capital, the compulsory acquisition rules should be modified.[115]

Justification for the compulsory acquisition rules may, in Australian law, be found in the tax benefits concomitant to 100% ownership. Consequently, facilitating the acquisition of the

[115] Fong, Ramsay & Boros 1998. See also the discussion of Lessing 1999:287 – 294 on the reforms enacted.

remaining shareholding should be promoted to prevent greenmailing.[116] In the alternative, it prevents the remaining shareholders' risk of being trapped in a small minority and unable to dispose of their securities. This offer will be triggered by a mere agreement to sell.[117]

The following two proposals were consequently put forward:

> "The current law allows compulsory acquisition of minority interests in certain circumstances. This should be expanded to facilitate acquisition of the outstanding securities in a class by any person who already holds 90% of the class. If 10% by value of the main holders dissented, the acquisition would only be able to proceed with court approval of the fairness of the price.
>
> The existing compulsory acquisition rules and procedures should be streamlined by:
>
> - Enabling takeover bids and post-bid compulsory acquisitions to be for all classes of securities; and
> - Providing that post-bid compulsory acquisitions can proceed if the bid was accepted by the holders of 75% by value of the outstanding securities (rather than by 75% of the number of holders as currently required)."

While this proposal refers to the compulsory acquisition of all securities in the relevant class, the following proposal refers to compulsory acquisition of all securities in the company and is framed in the following terms:-

> "The current law in relation to compulsory acquisition of minority interests could be expanded to facilitate the acquisition of 100% of the shares or any securities convertible into shares of a company by any person holding at least 90% by value of those shares and securities provided that they also hold at least 90% of the voting rights of the company. If 10% by value of the minority security holders of any class dissented, the acquisition of that class would only be able to proceed with court approval of the fairness of the price. The government will consider whether the compulsory acquisition provisions should be expanded in this manner in light of comment of this issue."[118]

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[116] Greenmailing refers to shareholders holding out in the hope of attracting a significantly better price.
[117] CLERP Policy Reforms 1997:4.
[118] CLERP Paper No 4: 31-32.

One of the criticisms levied against the reforms proposed in terms of CLERP is that the authority of the court to adjudicate the fairness of a take-over scheme is limited to the fairness of the consideration offered.[119]

The Chapter 6A amendment proposals in the CLERP Bill, which have been enacted as a new Chapter 6A in the Act, aimed to modify and extend the existent regulation of compulsory acquisition previously contained in sections 701 and 703.[120] The provisions are now contained in the Corporations Law in sections 661A - E as they relate to compulsory acquisition following a takeover bid, sections 664 A – F on the general right to compulsory acquisition and section 670 as it relates to the compulsory buy-out of convertible securities by 100% holder.

One of the effects of this more facile regulation is that the 90% threshold is no longer cast in stone, but may be lower. This shift was justified, not only to accommodate cases where shareholders could not be traced, but also situations where the target company dilutes interests by issuing additional shares, and where a bidder's shareholding is only marginally below the required threshold.[121]

The offeror gains the right to compulsorily acquire all the securities in the bid class issued in which the shareholder does not hold a relevant interest. This includes securities or interests which will convert to securities in the bid class and interests which will confer rights to be issued securities in the bid class that may be exercised.[122]

The proposed procedure requires that the bidder gives the target company a copy of each section 661B compulsory acquisition with a transfer of the relevant securities signed as transferor by someone appointed by the bidder and as transferee by the person acquiring the securities.[123]

In addition, part 6A.2 proposes the introduction of a power of compulsory acquisition outside the context of the takeover bid.[124] While the exact levels of shareholding required have been refined significantly, the procedures in the act are still principally the same.[125] A holder of 90% of the issued securities in a class or in multiple classes may acquire the outstanding shares in that class or classes for cash only.[126]

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[119] Boros 1998:291.
[120] Black et al 1998:120.
[121] Black et al 1998:122.
[122] CLERP Bill 1998:s 661A(4)(a) & (b); Black et al 1998:122 – 123.
[123] CLERP Bill 1998:s 666B; Black et al 1998:123 – 124.
[124] CLERP Bill 1998:Part 6A.2; Black et al 1998:125.
[125] Corporations Law: section 661E.
[126] CLERP Bill 1998:s 664B; Black et al 1998:126.

The minority shareholders are also afforded the right to object to this acquisition by signing an objection form and returning it to the majority shareholder. Should less than 10% of the minority shareholders object, the majority shareholder may proceed with the acquisition. In all other instances the majority shareholder must then elect to either cancel the process or apply to court for approval of the acquisition.[127] Such approval may be gained upon proof of fair value for the securities to be acquired.[128]

The provisions relating to the power of a 90% shareholder to compulsorily acquire the shares in a company came were promulgated in the Corporate Law Economic Reform Program Act 1999 and came into operation on 13 March 2000.[129]

6.8 Conclusion

Australian law, especially pursuant to the reforms introduced in the Corporate Law and Economic reform Programme, presents a number of unique extensions of familiar principles.

While the traditional minority shareholder protection mechanisms were to be found, the complete abolition of the rule in *Foss v Harbottle*, coupled with the introduction of a generous statutory derivative action and an even more generous remedy for shareholders, has significantly enhanced the scope of shareholder protection.

One of the developments that is especially significant in this study, is the generous protection offered section 232. On a reading of this section, it would be possible for a minority shareholder in a takeover to approach the court on the ground that he/she will be disadvantaged by the majority's acceptance of an offer that would not be extended to him/her – a unfairly discriminatory action. It would then, in terms of section 233 be possible for the court to order either the company or the offeror to purchase those shares at a specified price.

Despite this, after a long process of investigation and consultation, it was found necessary to enact that mandatory bid as it is found in Australian law in order to more adequately safeguard the interests of minority shareholders.

In addition, some procedural reforms have been effected to a compulsory acquisition procedure that is reminiscent of the procedure found in the United Kingdom. It is submitted that the requirement that the remaining shareholders be supplied with an expert's report is a commendable measure. Such a report gives the shareholder all the information required to make

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[127] CLERP Bill 1998:ss 664E(1) & (4); Black et al 1998:127.
[128] CLERP Bill 1998:s 664F(3); Black et al 1998:127.
[129] Ramsay 2000.

a sound and beneficial decision. In addition, the right to approach a court to stop the acquisition contained in section 661 E, provides an added safeguard.

It is of considerable significance that all of these reforms have been effected in Australia and it remains to investigate the South African dispensation in order to evaluate it against the measures in the jurisdictions reviewed so far.

CHAPTER 7

SOUTH AFRICAN LAW

7.1 Introduction

This chapter will examine the South African takeover regime and will focus in detail on the provisions relating to the protection of minority shareholders, as well as judicial interpretation of those provisions. The inherent tension in the construction of such mechanisms has been aptly summarized:

> 'No system can wholly protect fools from their own folly or from the knavery of others, and the disadvantages of trying to do as fully as possible, have to be weighed against the disadvantages of imposing fetters on business conducted honestly and efficiently.'[1]

At the inception, the regulation of takeovers and mergers will be studied as an arena indigenous to company law in which shareholders are as often as not faced with significant changes to the management of the company in which they originally invested. The conjectured legislative motivation for the promulgation of provisions regulating takeovers, was aptly summarised by Diemont JA in *Spinnaker Investments (Pty) Ltd v Tongaat Group Ltd* as:[2]

> 'compromising between conflicting principles; [the Legislature] recognised that the free enterprise economy and the freedom to contract must not be unduly inhibited; indeed, it should to some extent be facilitated. On the other hand, shareholders must not be put at too great a disadvantage and must receive some measure of protection when a take-over scheme is proposed and carried out.'

This contention is still recognised as the philosophy underlying the regulation of securities in South African Law.[3] Each of the main mechanisms for effecting takeovers will be studied in order to highlight the particular exposure of minority shareholders in each and against this background the two main minority shareholder protection mechanisms. Within this particular substratum of the life of the company, minority shareholders are as frequently at risk as in any

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[1] The Cohen Committee of Enquiry into the English Companies Act in 1945 as quoted by Diemont JA in *Spinnaker Investments (Pty) Ltd v Tongaat Group Ltd* 1982 (1) SA 65 (A):71.
[2] *Spinnaker Investments (Pty) Ltd v Tongaat group Ltd* 1982 (1) SA 65 (AD):71.
[3] Meskin 1994:962.

other, and, with due recognition to this fact, the law provides protection for those who may find themselves on the receiving end of an unfavourable shift in corporate control. Both the compulsory acquisition procedure and the mandatory bid requirement will be studied in detail with full reference to applicable judicial precedents where those precedents serve to expose the rationale and functionality of each remedy. Other mechanisms aimed at supporting the broader principle of equal opportunity in the Securities Regulation Code will also be highlighted.

In conclusion, the efficacy of the remedies will be examined against the backdrop provided by the Standing Advisory Committee on Company Law's invitation of comments on the mandatory bid, specifically.

7.2 Chapter XVA of the Companies Act: Regulation of securities

The current dispensation for takeovers and mergers is firmly rooted in the provisions of Chapter XVA of the Companies Act[4] headed 'Regulation of securities.'

The 1926 Companies Act[5] made no specific provision for the regulation of take-overs and mergers,[6] but did contain a compulsory acquisition provision.[7] Pursuant to the recommendations of the Van Wyk de Vries Commission provision was made for the regulation of takeovers in the (then) sections 314 to 321 of the 1973 Companies Act.[8] The ambit of regulation was not particularly extensive[9] due to the narrow definition afforded to the concept 'take-over scheme',[10] which ignored a number of take-over methods widely acknowledged today.[11]

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[4] Companies Act 61 of 1973.
[5] Companies Act 46 of 1926.
[6] Blackman 1994:par 258.
[7] This provision, also referred to as the 'onteieningsbepaling' enabled an offeror, upon acquisition of 90% of the securities in a target company, to acquire the remaining securities in that company, irrespective the desire of the minority shareholders to dispose of those securities. See also 3.2 below on the current provisions of section 440 K of the Companies Act 61 of 1973.
[8] Companies Act 61 of 1973.
[9] One of the problems identified with the dispensation at that time, was that parties acting in concert after a shift in shareholding to suddenly exert a new control, were not adequately provided for. Kilalea 1988:2.
[10] A take-over scheme was defined as a scheme involving the making of an offer for the acquisition of the shares of the target company, which, together with the shares in that company already in possession of the person making the offer, would result in either of the following:-
a) that the control in the target company would vest in the person making the offer; or
b) that the offeror would then possess either all the shares in the company or all the shares in a particular class of shares.
[11] Blackman puts forward in this regard specifically the following methods:-
a) the scheme of arrangement procedure;

Pursuant to a second investigation, the Companies Amendment Act of 1989, promulgated on the recommendation of the Standing Advisory Committee on Company Law,[12] established the Securities Regulation Panel and tasked it with the responsibility for the regulation of 'affected transactions', which includes takeovers and mergers.[13] The Panel was also empowered to make rules for the regulation of such affected transactions[14] and was afforded extensive powers of investigation.[15] Sections 440A through 440J were introduced into the Companies Act in this manner, and came into operation on 26 January 1990.[16] Sections 440K, 440L, 440M and 440N were included in the Companies Act[17] by means of Act 69 of 1990 and commenced on the 1st of February 1991, effectively repealing the previous sections 224, 229-233 and 314-321 from the same date.

Section 440 A inserts a number of definitions specific to the context of a chapter regulating securities. While a 'company' is defined in section 1[18] to include companies incorporated under Chapter IV of the Act and any body which immediately prior to the commencement of the Act was a company in terms of any law repealed by it, the term 'company', used in Chapter XVA, includes external companies and other bodies corporate.

The Securities Regulation Panel is established by means of section 440B and the exact composition of the panel,[19] the designation of its chairman,[20] terms of office[21] and similar matters regulated in that section . Provision is also made for the appointment of an executive director[22] and an executive committee,[23] to whom such powers may be delegated as the panel decides.[24]

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b) the reduction of capital method; and
c) the conversion and redemption of redeemable preference shares method.

[12] Blackman 1994: par 259.

[13] Companies Act 61 of 1973: s 440 B. See also Cilliers et al 2000:299; Pretorius et al 1999:568; Gibson 1997:401; Cilliers et al 1992:458 – 459.

[14] Companies Act 61 of 1973: s 440 C.

[15] Companies Act 61 of 1973: s 440 D.

[16] Sections 440B, 440F and 440G came did not come into effect on 26 January 1990. The date of commencement of section 440B was 1 October 1989 and the date of commencement of sections 440Fand 440G was 1 February 1991.

[17] Companies Act 61 of 1973.

[18] Companies Act 61 of 1973.

[19] Companies Act 61 of 1973: sections 440B (2) read with sections 440B (3) and 440B (6).

[20] Companies Act 61 of 1973: Section 440B (4). The position of acting chairman is provided for in section 440B (5).

[21] Companies Act 61 of 1973: section 440B (7).

[22] Companies Act 61 of 1973: section 440B (11).

[23] Companies Act 61 of 1973: section 440B (12).

[24] Companies Act 61 of 1973: section 440B (14).

Section 440C outlines the functions of the panel[25] and confers the power to make rules in respect of the matters falling within the provisions of Chapter XVA of the Companies Act.[26] This section forms the basis of the rules issued by the Panel.

The finances of the panel are broadly regulated under section 440E and the liability of the panel, its members and officers is limited by the provisions of section 440J, provided that the relevant actions were performed in good faith in the performance of a power or duty duly conferred in the provisions of Chapter XVA.

Investigations by the panel are authorised in section 440D in so far as the investigations are performed for the purposes of performing the functions of the panel. The obligation to furnish certain information to the panel is imposed on the beneficial owners of prescribed percentages of any class of securities dealt with on a stock exchange by section 440G.[27] Failure to comply with the provisions of this section constitutes an offence.[28] The duty to preserve secrecy is, however, imposed on those persons carrying out functions in terms of the act by the provisions contained in section 440I.

Section 440F, aimed at the regulation of insider trading has been repealed by the Insider Trading Act 135 of 1998.

While section 440H asserts that the provisions of chapter XVA shall supplement any other law, it does so provided only that the other law is not in conflict with it. In addition, the provisions of the Maintenance and Promotion of Competition Act shall not apply to the actions of the panel.[29]

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[25] Companies Act 61 of 1973: section 440C (1). The functions of the panel include the regulation of all affected transaction and all proposals that will, upon successful completion, constitute affected transactions. The panel is also to supervise all dealings in securities within the scope of Chapter XVA.
[26] Companies Act 61 of 1973: section 440C (3).
[27] Companies Act 61 of 1973: section 440G (1).
[28] Companies Act 61 of 1973: section 440G (2).
[29] Companies Act 61 of 1973: section 440N; A new South African Competition Act 89 of 1998 came into effect on 1 September 1999. Chapter 3 of the Act governs merger control, where a merger is defined to include the acquisition of control through the acquisition of shares in the business of a competitor in terms of that act. Control may, inter alia be achieved through ownership of more than half of the issued share capital of a company or holding the majority of voting rights. Such mergers are classified in terms of turnover thresholds as either intermediate or larger mergers and according to this classification, notice has to be given to both the Competition Commission and the representative trade unions in the companies involved. No merger in terms of this act may be completed except with the permission of the Competition Commission. This Commission has the power to prohibit implementation of the merger and need apparently only publish reasons for this prohibition when it applies to a larger merger in terms of turnover. Mergers may be prohibited if likely to substantially prevent or lessen competition and an appeals system of sorts is set up via a Competition Tribunal to a Competition Appeal Court.

Section 440M contains those provisions that give the panel the authority to institute legal proceedings against parties in contravention of the rules they are duly authorised to make and enforce. The panel may approach the court for an order compelling any person subject to the rules, in contravention of the rules, to comply with those rules and the court may, in its discretion, issue such an order.[30] In circumstances where a contravention of the rules is either imminent or confirmed, the panel may approach the court for an order:-

a) prohibiting the anticipated contravention in the case of imminent contravention;

b) prohibiting either the repetition or continuation of a confirmed contravention; or

c) prohibiting the person from continuing with an affected transaction or a proposed affected transaction.[31]

Upon confirmation of the necessary facts, the court may, even upon affirmation of the likelihood of the contravention of the rules, issue the order applied for.

Notwithstanding these provisions, any person in contravention of the rules, shall be liable for any loss or damages suffered by any other party as a result of the contravention.[32] It is in section 440K that the equal opportunity principle surfaces with the provisions governing the compulsory acquisition of the securities of the minority shareholders in an affected transaction. These provisions will be discussed in detail below.[33]

7.3 Take-overs and mergers

The term 'take-over' refers colloquially[34] to the acquisition of control over the disposition of the assets of a company and in this context the term 'control' will effectively refer to control over the management of a company.[35] The management of a company vests in the board of directors and those directors are appointed in general meeting by the majority of the shareholders in the company. It follows that control of the composition of the board vests in the person able to muster sufficient votes to ensure the passing of resolutions proposed at the general meetings of the company.[36]

Control of a company may assume four distinctly separate forms:-

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[30] Companies Act 61 of 1973: section 440M (1).
[31] Companies Act 61 of 1973: section 440M (2).
[32] Companies Act 61 of 1973: section 440M (4).
[33] See 7.4 below.
[34] The term 'takeover' does not have any legally defined meaning and is neither defined nor used in the Securities Regulation Code on Takeovers and Mergers. See Luiz 1997:239.
[35] The Van Wyk de Vries Commission 1972: par 69.04 defined a take-over as the acquisition of control of the company through the purchase of a sufficient number of shares to confer control. See also the distinction drawn by Luiz 1997:239 between a takeover, which is defined as a transaction in terms of which control of a company is acquired, and a merger which is described as an arrangement in terms of which the assets of two or more companies are merged under the control of one company.

a) complete control, which is established when the person holding that control is able to exercise all the voting rights at the meetings of the company concerned;

b) majority control, which entitles such a person to exercise more than half the voting rights;

c) minority control, in terms of which the controlling party is not able to exercise more than half the votes, but such a number of votes as is sufficient to establish *de facto* control of the company; or

d) management control, which is linked to control over the proxy voting machinery in companies where the shares issued are widely held.[37]

The acquisition of control may be effected through takeovers, which form the parameters of this discussion on the protection of the interests of minority shareholders, mergers, amalgamations or absorptions whereby the assets of multiple companies become vested, directly or indirectly through subsidiaries, in a single company[38] or reconstruction whereby the shareholders of a company agree to transfer the whole of its undertaking to another company in exchange for shares in that company.[39]

The Van Wyk de Vries Commission received a substantial amount of evidence and proposals on the regulations of takeovers and studied almost all takeover bids conducted in the period of over twenty years preceding its report.[40] The role of the Companies Act in respect of takeovers and mergers was described in the following terms:-

> 'Generally the Companies Act seeks to afford the public and shareholders protection against abuse inherent in a take-over situation and to ensure that fair dealing takes place.'[41]

More specifically, however, the Commission identified a number of interests involved in any take-over, namely those of the offeror company and its shareholders, those of the offeree company, those of the shareholders of the offeree and those of the creditors, but found that only the shareholders of the of the offeree company were in need of protection.[42] This interest was found not to be adequately protected in law.[43]

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[36] Cilliers et al 1992:456.
[37] Cilliers et al 1992:456.
[38] This may done by means of either restructuring the share capital of one of the companies in a merger or by the formation of a new company.
[39] Cilliers et al 1992:457 – 458.
[40] Republic of South Africa1972:par 69.01.
[41] Republic of South Africa1972:par 69.03.
[42] Republic of South Africa1972:par 71.05
[43] Republic of South Africa1972:par 71.07.

The shareholders of the offeree company, it was held, were exposed to two primary, interdependent risks: the change of control coupled with the price he/she would be offered for their shares.[44] If the price of the offer was fair, the change in control would not matter due to the fact that the shareholder would have reasonable opportunity to exit the company at a good price. If a change in management is favourable, then price does not matter because the shareholder will elect to keep his/her shares. The Commission elected to ensure fair price, reliable information to consider fair price and sufficient time to do so.[45]

The provisions which have at various stages been contained in the Companies Acts will now be examined with reference to their main provisions and efficacy in the protection of minority shareholders.

7.3.1 Background and development

7.3.1.1 The former section 103 ter

Section 103 of the Companies Act 46 of 1926 made provision for reconstruction or amalgamation. The mechanisms that form the focus of this study, may be found in section 103 ter.[46]

Section 103 ter had two primary purposes. Firstly, it aimed to establish a mechanism with which an offeror was enabled to dispossess the shareholders of the offeree who had not accepted his/her takeover offer. Secondly, it afforded the offeree the right to require the offeror to acquire his/her shares on the terms of the take-over offer.[47]

The construction of section 103 ter is principially the same as that currently contained in section 440K. It enabled a company, which had secured acceptances of his/her offer from nine tenths of the shareholders of the company (in value), to acquire the remaining shares pursuant to following a prescribed notice procedure. The effect of the execution of the notice was that the acquiring company became entitled and bound to acquire the outstanding shares, save in instances where a court ordered otherwise, pursuant to an application from a dissenting shareholder.[48]

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[44] Republic of South Africa1972:par 71.07.
[45] Republic of South Africa1972:par 72.08.
[46] Section 103 ter was introduced into the Companies Act 46 of 1926 in 1939 by section 65 of the Companies Amendment Act 23 of 1939.
[47] Republic of South Africa1972:par 76.01.
[48] De Wet & Yeats 1963:549 – 550.

This section was not viewed as regulating a take-over bid. It was termed as a provision which only operates after an offer has been made and accepted,[49] and a most unsatisfactory term at that.[50]

7.3.1.2 The former section 314

The regulation of takeovers and mergers, prior to the enactment of the current Chapter XVA, was primarily contained in this section. In fact, sections 314 to 321 comprised the entire statutory takeover regime with the provisions relating to takeovers effected by means of 311 to 313.[51] Take-over offers under a takeover scheme was regulated in terms of this section and a takeover scheme was consequently defined as:

> 'A scheme involving the making of an offer by the offeror for acquiring shares of the offeree company, which, together with any shares of that company already held by the offeror at the time of the making of the offer will have the effect of:
>
> a) vesting the control[52] of the offeree company, directly or indirectly, in the offeror, or
>
> b) the offeror acquiring all the shares or all the shares of a particular class of the offeree company,
>
> but does not include any offer made in the course of or in connection with any individual negotiation with any shareholder for the acquisition of any such shares.'[53]

The scope of the protection afforded to shareholders in terms of these provisions were consequently limited to a single composite offer made to the shareholders of the offeree company.[54]

The principles of equal opportunity and equal information were contained in section 314(2) which forbade the making of a takeover offer unless the offer was made to all shareholders or to all holders of a class of shares and unless a takeover statement was annexed to that

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[49] Republic of South Africa1972:par 76.02. See also the comment of Luiz 1997:240 on the lack of any regulation of either the content of the offer or the procedure in respect of a general offer.
[50] Republic of South Africa1972:par 76.04.
[51] Cilliers et al 1977:333.
[52] Within this context the term 'control' primarily referred to control of the management of a company – this control vested, in most instances, with the holder of sufficient shares to control the appointment of the majority of directors in general meeting; Cilliers et al 1977:331.
[53] Companies Act 61 of 1973: section 314(1); De Wet en Van Wyk 1978:736 – 737.
[54] *Spinnaker Investments (Pty) Ltd v Tongaat Group Ltd* 1982 (1) SA 65 (AD); Gibson 1983:454 – 455.

offer.[55] Aptly, the aim of these provisions were described as mechanisms aimed at ensuring that all the shareholders in the target company are treated the same.[56] This entailed that the offer was also to be made on the same terms to all the shareholders or all the holders of a class of securities,[57] a requirement which could only be dispensed with upon the written agreement of all the shareholders in the offeree company.[58]

The shortcomings identified in section 103 ter, were improved in a number of ways with the enactment of section 314. The 'offeree'/'offeror' terminology was termed more precise and less confusing than the 'transferor'/'transferee' in section 103 ter.[59]

The waiting period prior to the issuing of the prescribed notices was shortened and an extended period within which the dissenting shareholder can apply to court for the envisaged order, inserted. In addition, a clear provision relating to the fact that distinctions are made between classes of shares was appended to the provisions.[60]

7.3.2 Chapter XVA

The current chapter XVA and the Securities Regulation Code on Takeovers and Mergers[61] are applicable to all takeovers as affected transactions.[62] The provisions of section 440L prohibit any person from entering into or even proposing an affected transaction except in accordance with the Rules.[63]

Any departure from these rules is only possible when the Panel exempts such a person from compliance.[64] The Panel is also granted a general discretion to authorize the departure from any requirement of the Code and to excuse or exonerate any party from failure to comply with any such requirement, subject to such terms and conditions as it may prescribe.[65]

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[55] Gibson 1983:455.
[56] De Wet and Van WyK 1978:737.
[57] Van Jaarsveld 1983:178.
[58] Van Jaarsveld 1983:178; De Wet and Van Wyk 1978:737.
[59] A number of other terminological improvements were effected, such as a better definition of the term 'scheme', a clarification of the term 'approved by the holders of no less', 'date of the offer' and 'value of the shares'.
[60] Republic of South Africa1972:par 77.05.
[61] The Code was promulgated under GN R290 of 18 January 1991.
[62] Cilliers et al 2000:299; Pretorius et al 1999:568; Luiz 1997:239; Gibson 1997:401; Ciliers et al 1992:459.
[63] Companies Act 61 of 1973: section 440L.
[64] Companies Act 61 of 1973: section 440L.
[65] Securities Regulation Code on Takeover and Mergers: Rule 34.

The application of these provisions governing takeovers and mergers depend on the satisfaction of two broad criteria.[66] Firstly, the transaction must be an affected transaction. An affected transaction is any transaction and also a transaction that forms part of a series of transactions, in any form, which:-

a) has the effect of either vesting control in a person who did not control hold control, or the acquisition of all the securities in a class by a single person; or

b) involves the acquisition of any number of shares exceeding the limits prescribed in the rules; or

c) constitutes the disposal of the undertaking of the company or a significant part thereof, or the assets of a company or a significant part thereof.[67]

Secondly, the company in question must be:-

a) a public company, but need not be listed on any stock exchange; or

b) a statutory corporation, either resident in the Republic or deemed to be so resident; or

c) a private company, provided that the sum of the amount of the value of shares under transaction and the value of the loans involved exceeds R 5 000 000 and the number of beneficial shareholders[68] exceeds ten.[69]

Within the parameters set by these criteria, it is possible to effect takeovers and mergers in any number of ways, such as the purchase or exchange of shares,[70] the so-called 'scheme of arrangement procedure',[71] the reduction of capital method,[72] the redeemable preference shares method[73] and other methods such as the modification of shareholders rights.[74]

It is necessary to study each of these methods of effecting takeovers individually in order to assess the possible impact of uniquely applicable provisions on the protection of minority shareholders in affected transactions.

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[66] Meskin 1994:962.
[67] Companies Act 61 of 1973: section 440A. See also Cilliers et al 2000:299 – 300; Pretorius et al 1998:568 – 569; Gibson 1997:401;Cilliers et al 1992:459.
[68] The beneficial shareholder is the person entitled to the earnings of those shares; Meskin 1994:210; In *Sammel and Others v President Brand Gold Mining Co Ltd* 1969 (3) SA 629 (A) at 642 the position was addressed with reference to the nominee (as opposed to the beneficial owner). A nominee was defined in the following terms: 'In the ordinary use of language, a person who holds shares as a nominee is a person who holds them in name only but who really, actually and in fact holds them for someone else, without himself having any real, actual or beneficial interest in them. Thus where shares are registered in the name of A but are, in reality and in fact held by A for B, A is said to be B's "nominee".
[69] Securities Regulation Code on Takeovers and Mergers Section A: Par 3; Cilliers et al 1992:460.
[70] Blackman 1995: par 253; Cilliers et al 1992:462.
[71] Blackman 1995: par 254; Cilliers et al 1992:462.
[72] Blackman 1995: par 255; Cilliers et al 462.
[73] Blackman 1995: par 256; Cilliers et al 1992:462.
[74] Blackman 1995: par 257; Cilliers et al 1992:462.

7.3.3 Methods of effecting takeovers

7.3.3.1 The purchase or exchange of shares

A take-over achieved by means of the purchase or exchange of shares[75] can be achieved either by individually negotiating agreements with the holders of the majority of securities in the target company, or by means of a take-over bid.[76] Such a bid entails the making of a general offer to either all the shareholders of the offeree or one or more class of shareholders to purchase their shares or exchange their shares for shares in the offeror.[77]

Take-over bids, as stated above, are governed by the provisions of Chapter XVA of the Companies Act[78] and regulated by the Securities Regulation Code on Takeovers and Mergers.[79] The safeguards provided for in these provisions, will be explained in detail below.

7.3.3.2 The scheme of arrangement procedure

Section 311 of the Companies Act[80] offers a statutory scheme of arrangement procedure, which is typically aimed at the company in financial difficulty.[81] This section contains, *inter alia*, the following provisions:-

> '(2) If the compromise or arrangement is agreed to by—
>
> (a) a majority in number representing three-fourths in value of the creditors or class of creditors; or
>
> (b) a majority representing three-fourths of the votes exercisable by the members or class of members,
>
> (as the case may be) present and voting either in person or by proxy at the meeting, such compromise or arrangement shall, if sanctioned by the Court, be binding on all the creditors or the class of creditors, or on the members or

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[75] Blackman 1995:par 253; Van Jaarsveld 1983:182 – 183; Macgregor 1979:36.
[76] This take-over bid is the 'tender offer' in American jurisprudence.
[77] Blackman 1995 at par 253 points out that in cases where the controller of the offeree company becomes the controller of the offeror company as a consequence of such an exchange of shares, the take-over is termed a 'reverse take-over.'
[78] Companies Act 61 of 1973.
[79] Blackman 1995:par 253.
[80] Companies Act 61 of 1973.
[81] Section 311(8) of the Companies Act 61 of 1973 expressly provides that (8) in this section "company" means any company liable to be wound up under this Act. In *Ex parte NBSA Centre Ltd* 1987 (2) SA 783 at 786, Coetzee DJP states:- 'The origin and *raison d'etre* of this provision is illuminating. The heading of the Joint Stock Companies Arrangement Act 1879 (33 and 34 Vic Ch 104) reads 'An act to *facilitate* compromises and arrangements between creditors and companies in liquidation'... '.

class of members (as the case may be) and also on the company or on the liquidator if the company is being wound up or on the judicial manager if the company is subject to a judicial management order.'[82]

It is possible to effect a takeover employing the scheme of arrangement to achieve the desired effect.[83] The co-operation of the company is vital to effecting a successful take-over by means of the scheme of arrangement procedure.[84] The arrangement is one between the company, its members and/or its creditors and may only be sanctioned by a court subject to the approval of the company.[85] This approval entails a decision taken by either the board of directors or a majority of its members in general meeting.

Take-overs in the form of a scheme of arrangement are often carried out by a cancellation of all[86] the issued shares of a company by way of a reduction of capital[87] and corresponding crediting of a special capital reserve account.[88] This action is immediately followed by a re-issuing of fully paid shares to the offeror. At the same time, the offeror pays the former shareholders the agreed consideration.[89]

It should be noted that the scheme of arrangement could possibly be utilised to effect an expropriation of the shares of minority shareholders.[90]

English jurisprudence also accepts the execution of a take-over by means of a scheme of arrangement where the arrangement merely consists of an agreement to either sell the shareholding to the offeror or to exchange such shares for shares in the offeror.[91] It has,

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[82] Companies Act 61 of 1973: s 311(1) & (2).
[83] Katz 1979:54; Macgregor 1979:37-38. See in general Luiz 1997:240 – 241. The scheme of arrangement procedure became popular in the late 1960's pursuant to the decision taken by an English court in *In re National Bank Ltd* [1966] 1 All ER 1006 (ChD).
[84] Blackman 1995: par 254.
[85] In terms of section 311(8) of the Companies Act 61 of 1973, the expression "arrangement" includes a reorganization of the share capital of the company by the consolidation of shares of different classes or by the division of shares into shares of different classes or by both these methods.
[86] All shares save for those perhaps already in possession of the offeror. Blackman 1995: par 254.
[87] The cancellation of issued shares has to take place within the parameters of the appropriate provisions of the Companies Act. The Companies Amendment Act 37 of 1999, however makes new provision for the purchase by a company of its own shares. Sections 38, 39, 76, 83, 84 and 85 of the Companies Act 61 of 1973 are amended to make provision for a company to acquire its own shares when the requirements of proper disclosure are met. The act states that a company may not acquire its own shares if it will be unable to pay its own debts or consolidated assets will be less than consolidated debts upon completion of the transaction. In the event of non-compliance, director's and shareholder liability is proposed as sanction in an amendment of section 86.
[88] Van Jaarsveld 1983:183.
[89] Blackman 1995: par 254; Cilliers et al 1992:463.
[90] Vermaas 1986:51 – 53.
[91] Blackman 1995: par 254.

however, been submitted that a more recent judgment of the Supreme Court of Appeal has opened the door to this practice in South African law.[92]

The use of this method to effect take-overs is contentious as it provides a mechanism for the circumvention of some of the provisions aimed at the protection of minority shareholders in take-overs and mergers.[93] It has, in fact been described as a means by which the company may expropriate the shares of minority shareholders.[94]

The Securities Regulation Code on Takeovers and Mergers makes express provision for offers implemented by means of a scheme of arrangement. In such cases, the company in respect of which the scheme is proposed shall be deemed to be the offeree company and all persons who stand to become the holders of the relevant securities upon completion of the scheme of arrangement, shall be deemed to be the offeror.[95]

7.3.3.3 The reduction of capital method

In the execution of this method of effecting a take-over, the offeror first acquires a stake in the offeree company. The company then applies for an order of court confirming a reduction of the issued share capital of the company by way of the cancellation of all issued shares not held by the offeror, along with the creation of a special reserve account equal to the amount by which the share capital is reduced.[96]

As is the case with the take-over effected by means of the scheme of arrangement procedure, the co-operation of the company is required for the successful execution, as a special resolution by the company is required. Section 84 of the Companies Act applicable to the method described above, has, however, been repealed in the Companies Amendment Act of 1999.[97] It is submitted that, where once the procedure described above applied, the method now entails not a reduction in capital, but the purchase by a company of its own shares.[98]

The procedure is envisioned as follows in the amended section 85:-[99]

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[92] Blackman 1995: par 254.
[93] See the discussion at 3.3 below.
[94] Golberg 1994:2.
[95] Securities Regulation Code on Takeovers and Mergers Section M: Rule 29.
[96] Blackman 1995: par 255; Cilliers et al 1992:463 – 464; Van Jaarsveld 1983:183 – 184; Katz 1979:54; Macgregor 1979:41 - 42.
[97] Companies Amendment Act 37 of 1999.
[98] The headings of both the relevant chapter and applicable section have been amended to read 'Acquisition by Companies of own shares'. Companies Amendment Act 37 of 1999:s 1(a) and 7.
[99] Companies Act 61 of 1973.

a) should provisions for such steps be made in the articles of the company, a company may purchase its own shares by means of a special resolution;

b) such approval may be either general approval or a specific approval for a particular acquisition;

c) general approval remains valid only until the next annual general meeting of the company, save in instances where it is varied or revoked by special resolution in any general meeting prior to the immediately following general meeting;

d) no payment for the purchase of such shares may be made if:-

   i) the company is unable to pay its debts as they become due in the ordinary course of business, or would be upon completion of the transaction; or

   ii) the consolidated assets of the company are valuated at a lesser amount than the consolidated liabilities of the company;

e) shares acquired under this section shall be cancelled as issued shares and restored to the status of authorised shares.

Provision is also made for the making of an offer by means of the reduction of capital in the Securities Regulation Code on Takeovers and Mergers. In such cases, the company undertaking the reduction shall be deemed to be the offeree company and the persons who will become the holders of the relevant securities after completion of the reduction will be deemed to be the offerors.[100]

In this manner the provisions of the Code relating to disclosure, timing and periods of notice are applicable to takeovers attempted and/ or effected by means of the reduction of share capital method.[101]

In addition, the Panel has the authority to require the exclusion of majority votes at relevant shareholders meetings in instances where the employment of this method is aimed at the elimination of a minority shareholding.[102] Despite this, the method has been described as a quick means to effect a change of control and for the expropriation of the shares of minority shareholders.[103]

One construction of the aforementioned rule 29(a)(ii) would have the effect of rendering the company purchasing its own shares in order to aid a take-over, both the offeror and offeree in the context. It is consequently submitted that, should the reduced shares be re-issued, the persons who will become the holders of those shares will still be considered the offeror.

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[100] Securities Regulation Code on Takeovers and Mergers Section M: Rule 29(a)(ii).
[101] Securities Regulation Code on Takeovers and Mergers Section M: Rule 29(a)(iv).
[102] Securities Regulation Code on Takeovers and Mergers Section M: Rule 29(b).
[103] Golberg 1994:3.

7.3.3.4 The redeemable preference shares method

A take-over by means of the redemption of redeemable preference shares is effected by converting all the shares in the target company not held by the offeror into redeemable preference shares and the redeeming those shares from the proceeds of a new issue of shares to the offeror.[104] Once again the co-operation of the company is required in order to obtain the special resolution required in terms of section 75(1)(i) and subject to sections 56[105] and 102.[106] Likewise, this method has been commented on as a method favourable to the expropriation of the shares of minority shareholders.[107]

This process is governed by the Companies Act[108] and regulated by the Securities Regulation Code on Takeovers and Mergers. The conversion of securities which aims to eliminate minority shareholding, is further subject to the provisions of rule 29(b) of the Code which grants the Panel the authority to exclude the votes of the majority shareholders all relevant meetings.[109] In such cases the company undertaking the conversion of shares shall be regarded as the offeree company and all persons who stand to becomes the holders of securities upon completion of the conversion are regarded as the offerors.[110] This means that the provisions of the Rules relating to disclosure, timing and periods of notice are applicable to takeovers affected by means of this method.[111]

7.3.3.5 Other methods

A take-over may be effected by simply issuing sufficient shares in the offeree company to the offeror to establish control of the target company. This may be done subject to the approval of the company by means of an ordinary resolution in general meeting to that specific effect, or by entrusting the directors with the general authority to do so.[112] In exercising this power conferred upon them, the directors of the company are constrained in their discretion by their fiduciary duties towards the company.

A modification of shareholder's rights may also be employed to accomplish a take-over. In such a process the articles of association of the company may be altered by special

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[104] Blackman 1995: Par 256; Cilliers et al 1992:464 – 465;Van Jaarsveld 1983:184; Katz 1979:54.
[105] Section 56 requires an alteration of the memorandum as to special conditions and certain other provisions.
[106] Companies Act 61 of 1973.
[107] Golberg 1994:3.
[108] Companies Act 61 of 1973.
[109] Securities Regulation Code on Takeovers and Mergers Section M: Rule 29(b).
[110] Securities Regulation Code on Takeovers and Mergers Section M: Rule 29(a)(ii).
[111] Securities Regulation Code on Takeovers and Mergers Section M: Rule 29(a)(iv).
[112] Blackman 1995:par 257.

resolution to empower either the directors or a class of shareholders to compel certain shareholders to sell their shares at a fixed price. This alteration of the articles may be done subject to the provision that the change is bona fide in the best interests of the company.[113]

In instances where such methods, other than the scheme of arrangement, reduction of capital, or conversion of securities, are employed to implement an offer, the Panel must be consulted in advance.[114]

7.4 Section 440 K: Compulsory acquisition

Section 440 K was introduced into the Companies Act 61 of 1973 in the Companies Second Amendment Act 69 of 1990. Similar provisions were contained in section 321 of the Companies Act[115] prior to the enactment of the 1989 Companies Amendment Act, which repealed the section.[116] Section 103*ter* of the 1926 Act[117] contained a comparable provision,[118] which was inserted by section 65 of the 1939 Companies Amendment Act.[119] In English jurisprudence, a similar provision was to be found in section 209 of the 1948 English Act,[120] as well as in the earlier United Kingdom Companies Act of 1929.[121] It has been submitted that due to the similarity in the provision contained thus, that regard may still be had to the cases decided with reference to those sections.[122]

The current section 440K contains the procedure to be followed upon the acquisition of 90% of the shareholding in a company, under the heading 'Compulsory acquisition of securities of minority in affected transaction.'[123]

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[113] Blackman 1995: Par 257.
[114] Securities Regulation Code on Takeovers and Mergers Section M: Rule 29(a)(iii).
[115] Companies Act 61 of 1973.
[116] Companies Act 78 of 1989: s 4.
[117] Companies Act 46 of 1926.
[118] Low 1974:8 – 12.
[119] Companies Amendment Act 23 of 1939.
[120] Meskin 1994:984.
[121] *Spinnaker Investments (Pty) Ltd v Tongaat Group Ltd* 1982 (1) SA 65 (A):71.
[122] Meskin 1994:984.
[123] (1) (a) If an offer for the acquisition of securities under an affected transaction involving the transfer of securities or any class of securities of a company to an offeror, has within four months after the date of the making of such offer been accepted by the holders of not less than nine-tenths of the securities or any class of securities whose transfer is involved (other than securities already held at the date of the issue of the offer by, or by a nominee for, the offeror or its subsidiary), the offeror may at any time within two months after the date of such acceptance give notice in the prescribed manner to any holder of such securities who has not accepted the said offer, that he or it desires to acquire his or its securities, and where such notice is given, the offeror shall be entitled and bound to acquire those securities on the terms on which under the affected transaction the securities of the holders who have accepted the offer, were or are to be transferred to the offeror, unless on an application made by such holder within six weeks from the date on which the notice was given, the Court—
(i) orders that the offeror shall not be so entitled and bound; or

This section is aimed at enabling an offeror who obtains 90% of the securities in a company in an affected transaction to acquire any or all of the remaining securities on the same terms as the 90% shareholding was acquired and to enable any minority shareholder in the same situation, to compel the offeror to purchase his/her securities in the same manner.[124]

In these broad terms, the provisions qualify not only as measures aimed at the protection of minority shareholders, but also as measures protecting the majority. The original legislature was concerned that an offeror who has expended considerable amounts of money in anticipation of acquiring complete control of the target company should not be frustrated by a small minority from the financial, administrative and commercial benefits inherent in such an acquisition.[125]

Section 440 K provides the minority shareholder in the target company in an affected transaction with dual protection in a situation where the offeror has acquired a 90% shareholding. The minority may opt out and compel the offeror to acquire their shares if they no longer wish to be members of the company[126] or the minority may opt either in or out and apply to a competent court for an order that the offeror is not entitled to such compulsory acquisition of shares or for an order imposing conditions of acquisition different from those of the offer.[127]

Though only the latter protection is recognised by some authors on the topic,[128] it is submitted that the opt-out offered to minority shareholders, sustains some measure of protection to the shareholder who finds himself suddenly in the hands of new management.

(ii) imposes conditions of acquisition different from those of the offer.
(b) If the said offer has not been accepted to the extent necessary for entitling the offeror to give notice under subsection (1) (a), the Court may, on application by the offeror, issue an order authorizing him to give notice under that subsection if the Court is satisfied that—
(i) the offeror has after reasonable enquiry been unable to trace one or more of the persons holding securities to which the offer relates;
(ii) the securities whose transfer is involved, by virtue of acceptances of the offer, together with the securities held by the person or persons referred to in subparagraph (i), amount to not less than the minimum specified in subsection (1) (a); and
(iii) the consideration offered is fair and reasonable,
but the Court shall not issue an order under this paragraph unless it considers that it is just and equitable to do so having regard, in particular, to the number of holders of securities who have been traced but who have not accepted the offer. Companies Act 61 of 1973: s 440 K (1).

[124] Meskin 1994:984.
[125] Blackman 1995:par 377.
[126] Meskin 1994:984.
[127] Companies Act 61 of 1973: s 440K(1)(a)(2).
[128] Hurter 1996:400.

7.4.1 The procedure

Once an offer to obtain either all the securities of the offeree, or all the shares in a class of shares issued by the offeree, has been accepted by the holders[129] of 90%, the offeror has a further two months to effect the compulsory acquisition of the remaining shares in the target company.[130]

7.4.1.1 The coercion notice

Should such acceptance occur within a period of four months, fhe first step in this procurement process involves the issuing of a notice, commonly referred to as a coercion notice, to all those holders of securities who have not yet accepted the offer indicating his/her desire to obtain such securities.[131] Section 440K(a)(1) refers to notice to be given 'in the prescribed manner', but no further reference is made to this prescribed manner.[132] It has been submitted that regulation 31 of the Companies Administration Regulations be applied here in the same manner that it applied to the repealed section 321 of the Companies Act.[133]

The applicable notice must be addressed by registered mail to all the holders of either the remaining shares, or the remaining shares in a class of shares, and must include the following information:-

a) the name of the offeror and of the subsidiaries of the offeror, if applicable;
b) the name of the target company involved;
c) the number and description of shares already acquired by the offeror or its subsidiaries as well as the acquisition consideration relevant to those securities;
d) the number and description of the shares held by the addressee in terms of the records of the company;
e) the fact that the offeror may acquire his/her shares; and
f) that, if this notice is given, the offeror is entitled and bound to acquire those shares on either the same terms as accepted by the majority or such terms as the court may prescribe on the application of either the offeror or the shareholder.[134]

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[129] From these holders of securities are excluded the offeror, the nominees of the offeror and his/her subsidiaries and the calculation of acquisition is based on the holdings of the so-called disinterested majority. Cilliers et al 1992:465.
[130] Companies Act 61 of 1973: s 440K(1)(a); Hurter 1996:397; Cillers et al 1992:465.
[131] Companies Act 61 of 1973: s 440K(1)(a); Hurter 1996:398; Blackman 1995:par 378; Cilliers et al 1992:466.
[132] Cilliers et al 1992:466.
[133] Meskin 1994:988; Cilliers et al 1992:466.
[134] Companies Administrative Regulations: Regulation 31 as promulgated under Government Notice R 1984 on the 19th of October 1973; Blackman 1995:par 379.

Once such notice has been given, the offeror is entitled and bound to acquire those securities.[135]

Even where the offeror does not hold the required 90%, he/she may apply to court for an order entitling him/her to issue such a notice.[136] The court will give such an order if it is satisfied that:-

a) the offeror has made reasonable enquiries as to the particulars of the remaining holders of securities and has been unable to trace those persons;[137]

b) that the securities that stand to be transferred will, together with the securities already held by the offeror exceed 90%;[138]

c) that the consideration offered is fair and reasonable;[139] and

d) when the court court considers it just and equitable to do so with reference to the number of holders of securities who have been traced but who have not accepted the offer.[140]

On the expiration of a period of six weeks after the issuing of the notice, the offeror must effect the compulsory acquisition by transmitting a copy of the coercion notice to the offeree, along with an instrument of transfer executed on behalf of the holders. This must be accompanied by payment of the price or representation for the acquisition of those shares. In turn, the offeree company is then obliged to register the offeror as the holder of those securities.[141]

The consideration paid in this manner is to be kept in a separate bank account at a registered banking institution in trust for the persons entitled to the securities in respect of which the sum was paid.[142]

7.4.1.2 The transfer notice

When the offeror either obtains or stands to obtain, a shareholding of 90%, he/she is required to give notice of that fact within a month to the holders[143] of the remaining shares in the

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[135] Companies Act 61 of 1973: s 440K(a)(1); Blackman 1995:par380.
[136] Companies Act 61 of 1973: s 440K(1)(b); Hurter 1996:398; Cilliers et al 1992:466.
[137] Companies Act 61 of 1973: s 440K(1)(b)(i).
[138] Companies Act 61 of 1973: s 440K(1)(b)(ii).
[139] Though the Act lists only the first three requirements to be met categorically, it is submitted that the fourth requirement listed here and not sequentially numbered constitutes an additional requirement.
[140] Companies Act 61 of 1973: s 440K(1)(b)(iii).
[141] Companies Act 61 of 1973: s 440K(2).
[142] Companies Act 61 of 1973: s 440K(4); Blackman 1995: par 387.
[143] As is the case above, the holders of securities who has not accepted the offer, who are included in this class, includes those holders who have failed or refused to transfer their

prescribed manner. The remaining holders of shares then have a period of three months in which to require the offeror to acquire the securities in question. The offeror is then, in turn, bound to acquire those shares at either the same consideration as was in effect during the affected transaction or under such conditions as the court may deem fit upon application of the offeror or the holder of the relevant securities.[144]

This notice is commonly referred to as the transfer notice,[145] and will substantially be effected in the same form as described above in relation to the coercion notice. These two notices have no relative order, but serve two substantially different purposes. The transfer notice gives a dissenting holder of securities the right to require that his/her securities be bought, while the coercion notice places the same holder of securities on terms so that his/her securities may be seized by the offeror.[146]

7.4.2 The application to court by the dissenting shareholders

The issuing of the coercion notice and instrument of transfer to the offeree is conditional upon either the absence of an application by the dissenting shareholders in terms of section 440K(a)(1) or the absence of a court order issued in terms of the same section.[147]

A dissenting shareholder may apply to a competent court, within six weeks after the issuing of the coercion notice for either an order that the offeror may not be entitled or bound to acquire his/her shareholding or the imposition of acquisition conditions different from those of the offer.[148] Such an application may also be brought by way of summons.[149]

No provision is made for the circumstances in which the court could intervene in the manner envisaged here,[150] but the discretion awarded in this manner is wide[151] and must fundamentally be concerned with the fairness of the affected transaction as a whole:[152]

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securities to the offeror in accordance with the affected transaction. Companies Act 61 of 1974: s 440K(5).

[144] Companies Act 61 of 1973: s 440K(3); Blakman 1995: par 386.-

[145] Hurter 1996:399; Cilliers et al 1992:466. The transfer notice is termed a 'oordrags-kennisgewing' in Afrikaans, while the coercion notice is termed an 'afdwingingskennisgewing'.

[146] Cilliers et al 1992:467.

[147] Companies Act 61 of 1973: s 440K(2).

[148] Companies Act 61 of 1973: s 440K(1)(a)(i) – (ii); Hurter 1996:400; Cilliers et al 1992:467.

[149] *Sammel v President Brand Gold Mining Co Ltd* 1969 (3) SA 629 (A); Cilliers et al 1992:467.

[150] Hurter 1996:400; Cilliers et al 1992:468.

[151] Meskin 1994:989.

[152] Hurter 1996:400; Meskin 1994:989; Cilliers et al 1992:468.

> 'The test of fairness is whether the offer is fair to the offerees as a body and not whether it is fair to a particular shareholder in the peculiar circumstances of his own case'[153]

The current approach was formulated in *Re Hoare & Co Ltd* [154]: the court views the take-over as fair *prima facie*, due to the fact that it has been accepted by such a large number of the shareholders[155] in the offeree company.[156] The onus is accordingly on the dissenting shareholder to convince the court that the offer is not fair or that special circumstances exist which would justify the court to order otherwise.[157] Such special circumstances may include possible misrepresentation bearing influence on the decision of the majority shareholders or a conflict between the interests of the majority shareholders and the minority shareholders.[158]

Other considerations relevant to the adjudication of the fairness of the take-over have also developed in South African law. In the case of *Sammel v President Brand Gold Mining Co Ltd*,[159] the court held, due to the specific circumstances of the case,[160] that both the interests of the creditors and the shareholders must be taken into consideration.[161] It has also been held, in the case of *Mia v Anglo-Alpha Cement Ltd*,[162] that the share values of both the offeror and the offeree company should be considered in cases where a offer involves the exchange of shares.[163] The fairness of the consideration, in turn is adjudicated with reference to the value of the shares to the shareholders of the offeree.[164]

The court is also not limited in its consideration to those factors offered to it. It may have regard to whether or not the shareholders were given sufficient and accurate information upon which to base their decision. In the same manner, the principles and rules of the Securities Regulation Code on Takeovers and Mergers may also be taken into consideration by the

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[153] Meskin 1994:990 quoting with approval the the dictum delivered by Plowman J in the case of *Re Grierson v Oldham & Adams Ltd* [1968] Ch 17 at 32.
[154] (1933) 150 LT 374.
[155] The principle is based on the assumption that the acceptors of the offer are all disinterested parties in the affected transaction. Blackman 1995: par 381.
[156] Blackman 1995: par 381.
[157] *Mia v Anglo-Alpha Cement Ltd* 1970 (2) SA 281 (W):283; Hurter 1996:401; Cilliers et al 1992:468.
[158] Hurter 1996:401; Blackman 1995: par 381.
[159] 1969 (3) SA 629 (A):671.
[160] Cilliers et al 1992:468. It is submitted by the authors that the emphasis on the rights of creditors in that case may be directly attributed to the fact that the take-over involved was part of a scheme which amounted to a compromise with the major creditors of the company.
[161] Hurter 1996:401; Cilliers et al 1992:468.
[162] 1970 (2) SA 281 (W):286.
[163] Hurter 1996:401; Cilliers et al 1992:468.
[164] Blackman 1995: par 382. The market price of a share is considered a cogent indicator of its value.

court before which the application is heard. The conduct of the parties during the offer may also be relevant and thus noted.[165]

The take-over may not simply be susceptible to criticism in order to render it unfair for the purposes of this section.[166] The test relates to the material fairness of the transaction and is adjudicated with reference to the process as a whole,[167] and the onus in proving it, rests on the dissenting shareholders bringing the application.[168]

This right is deemed by some to contain the true provisions relevant to the protection of minority shareholders for the opportunity it provides to bring relevant facts to court.[169]

7.4.3 Section 440 K and the scheme of arrangement procedure

While the purpose of this section is clear from both the wording and interpretation of the provisions of section 440 K, the use of the scheme of arrangement procedure to effect a take-over provides a distinct advantage.

Prior to the judgment in *Ex parte NBSA Centre Ltd*,[170] a divergence of judicial opinion prevailed in South Africa on the issue of whether or not a direct exchange of cash for shares could qualify as a scheme of arrangement in terms of section 311 of the Companies Act.[171]

In Natal, the case of *Ex parte Natal Coal Exploration Co*[172] presented not a take-over, but a scenario in which the owners of 92,8% of the issued shares in the applicant, for reasons irrelevant to the discussion, wished to become sole shareholders. Section 311 was employed, not to escape the provisions of the (then) section 321, but to afford the minority shareholders better protection than they may have been afforded under the provisions relating to a straight-forward reduction of capital.[173] Despite this, the court found that an arrangement in terms of section 311 could not be based on a simple exchange of cash for shares.[174]

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[165] Blackman 1995: par 381.
[166] Companies Act 61 of 1973: s 440K(1)(a).
[167] Blackman 1995: par 381.
[168] Blackman 1995: par 383.
[169] Hurter 1996:400.
[170] *Ex parte NBSA Centre Ltd* 1987 (2) SA 783.
[171] Companies Act 61 of 1973. See for instance the discussions of Deport 1994:166 – 175 and Oshry 1992:118 – 120.
[172] *Ex parte Natal Coal Exploration Co Ltd* 1985 (4) SA 279.
[173] The provisions relevant to a reduction of share capital at that stage required that a special resolution be passed at a general meeting of the company in terms of section 84 of the Companies Act 61 of 1973. The court finds at *Ex parte Natal Coal Exploration Co Ltd* 1985 (4) 279: 282 that the applicant's shareholding would have ensured a decision in favour of the majority of shareholders, with the resulting possibility that the minority shareholders would be liable to the compulsory deprivation of their shares for no equivalent or comparable rights. In

In the judgment of Coetzee DJP in *Ex parte NBSA Centre Ltd,*[175] it was likewise held that a scheme amounting to the compulsory purchase of its shares by a company with the ensuing reduction in share capital was illegal when achieved by means of the scheme of arrangement procedure under section 311.[176]

The judgments were delivered prior to the 1990 enactment of the Companies Second Amendment Act[177] and the introduction of section 440 K.

In a private company, however, the scheme of arrangement procedure may be used to effect a take-over. The provisions of the code apply only to cases where the transaction itself exceeds R 5 000 000 in share and/or loan value and there are at least 10 beneficial owners of shares involved.[178]

7.4.4 Sammel and Others v President Brand Gold Mining Co Ltd 1969 (3) SA 629 (A)

The case of *Sammel and Others v President Brand Gold Mining Co Ltd* [179] offers one of the most detailed (and one of the only) judgments on provisions similar to those currently contained in section 440K of the Companies Act.[180]

7.4.4.1 The facts of the case

The relevant take-over was structured as a reconstruction of the extensive debt and shareholding of the offeree company. This arrangement allowed President Brand Gold Mining Company, the respondent and offeror, to benefit from the transaction by availing itself of the opportunity to utilise both the assessed tax loss of the target company and its ore-processing

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comparison, the use of section 311 would at least afford the minority shareholders the opportunity to meet separately and would require a decision taken by 75% of those shareholders and have the result, in casu, of adequate compensation for the shares thus cancelled. At least four disctinct advantages to this procedure are identified at *Ex parte Natal Coal Exploration Co Ltd* 1985 (4) 279: 282:
a) The minority shareholders have the procedural advantage of a separate meeting;
b) The minority also has the added benefit of the information issued in terms of section 312;
c) The proposal tabled at this meeting cannot succeed without the approval of the holders of 75% of the so-called minority shares; and
d) on the facts of this case, the number of dissenting shareholders reliant upon the discretion of the court for the protection of its rights are reduced from a potential 25% to as little as 2%.

[174] *Ex parte Natal Coal Exploration Co Ltd* 1985 (4) 279:285.
[175] *Ex parte NBSA Centre Ltd* 1987 (2) SA 783.
[176] Companies Act 61 of 1973.
[177] Companies Second Amendment Act 69 of 1990.
[178] Meskin 1994:963.
[179] 1969 (3) SA 629 (A).

facilities. The offeree, in turn was saved from its severe financial distress and possible liquidation.

The reconstruction itself comprised a reduction in share capital and a re-issue of that capital, coupled with the issue of debentures. It was structured to result in a shift of shareholding by the consenting shareholders from 56% to 91%, a percentage shareholding sufficient to complete the take-over transaction with the invocation of provisions similar to the current section 440K,[181] as agreed upon by the parties. Due to the particular circumstances of the offeree, the take-over offer price was, however, low.

The action before the court was indeed brought in terms of section 103*ter* of the Companies Act 46 of 1926, as invoked pursuant to the reconstruction. This section was inserted by the 1939 Companies Amendment Act[182] and contained, essentially, the following provision:-

If a scheme or contract, resulting in the transfer of shares or a class of shares in the transferor company to the transferee company, within a period of four months from the making of the offer, has been approved by at least nine tenths of the shareholders (other than those already held by the offeror or his/her nominee),[183] the offeror is entitled and bound to obtain the shares of the dissenting shareholders if notice was given in the prescribed manner within a period of two months and the court did not issue an order to the contrary on the application of the dissenting shareholders on the same conditions as favoured the consenting majority.

Pursuant to the issuing of the prescribed coercion notice, several dissenting shareholders instituted the proceedings envisaged above, imploring the court to 'order otherwise'.

The court methodically analysed each relevant consideration, many of which are currently statutorily governed.

7.4.4.2 The interests to be considered in such an application

The court expressly made a finding relating to the solvency of the offeree company at the time of the take-over to distinguish the situation in this case from that of the normal take-over where only the interests of the shareholders need be considered.[184] In the circumstances of the offeree, the interests of the creditors were found to be foremost.

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[180] Companies Act 61 of 1973.
[181] Companies Act 61 of 1973.
[182] Companies Amendment Act 23 of 1939: s 65.
[183] The disqualification relating to the shares held by the offeror and his/her nominees was inserted by section 86 of Act 46 of 1952.
[184] *Sammel and Others v President Brand Gold Mining Co Ltd* 1969 (3) SA 629 (A): 661.

7.4.4.3 The nominee argument

It was argued for the appellants that the shares held by nominees and votes exercised in terms thereof had to be excluded from the calculation of the requisite nine tenths of shareholders for the purposes of section 103*ter*.[185] If this were the case, then the requisite would not be met and the dissenting minority not be so liable to be disowned.

The importance of the explicit inclusion of the term 'nominee' stems from the prohibition in terms of section 117 of the English 1948 Companies Act of the inclusion of the beneficial owner of shares in the company's register of members. The argument was, however rejected on the facts.[186]

The arguments in favour of a sufficiently wide interpretation of the facts was likewise rejected on the following grounds:-

a) the term 'nominee' was deemed to be sufficiently certain in meaning not to warrant such generous interpretation;
b) the court found no evident reason why the Legislature should have wished to exclude the acceptances of shareholders who agreed to do so in advance, especially if they were at that time independent of the control of the transferee;
c) if such pre-offer assents are not indicative of the fairness of the scheme, the wide discretion afforded the court is sufficient to safeguard the interests of the minority shareholders; and
d) the facts of *In re Bugle Press Ltd*,[187] upon which the appellants relied in support of this argument, refuted it.[188]

7.4.4.4 The discretion of the court

Section 103*ter*,[189] it was found, undoubtedly afforded the court a wide discretion to 'order otherwise'.[190] The relevant test, as to which circumstances would move the court to do so,

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[185] Companies Act 46 of 1926.
[186] *Sammel and Others v President Brand Gold Mining Co Ltd* 1969 (3) SA 629 (A): 666.
[187] (1961) 1 Ch. 67 (C.A.).
[188] *Sammel and Others v President Brand Gold Mining Co Ltd* 1969 (3) SA 629 (A): 668 – 669.
[189] Companies Act 46 of 1926.
[190] *Sammel and Others v President Brand Gold Mining Co Ltd* 1969 (3) SA 629 (A): 670.

relates, it was found, to the fairness of the scheme as a whole, which is in effect established *prima facie* by the acceptance thereof by 90% of the shareholders.[191]

The court also recognised that special circumstances may be put forward refuting this *prima facie* case, such as[192] misrepresentation, which possibly influenced the decision thus taken by the majority shareholders, unfair dealing; and a conflict of interest between the majority and minority shareholders of the offeree company.[193]

The burden of proof in this regard rests on the appellant or, in the court a quo, on the applicant.[194]

This test relating to the fairness of the scheme was held to be normally executed by the courts with reference to the best interests of the shareholders alone. Due to the particular circumstances and the virtual insolvency of the offeree, however, this case was decided with primary reference to the interests of the creditors, who obtained substantial shareholding in the reconstruction. This shareholding, in turn, was to be offered to the offeror in return for a fair consideration in excess of the likely dividend, should the company ultimately have been liquidated.

With these considerations identified, the court proceeded to evaluate the fairness of the offer with reference to the existence of any special circumstances as envisaged above.

7.4.4.5 Non-disclosure of relevant facts

On the facts the court had recourse to consider non-disclosure of relevant facts as it related to the decision of the shareholders to accept or reject the take-over offer.[195] This alleged non-disclosure related to the benefits to be gained by the offeror from the conclusion of the take-over as proposed.

In view of the applicable facts, however, and in the absence of any statutory obligation to disclose such information, the court found the non-disclosure irrelevant to the scheme as a

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[191] The court relied in this regard on the English precedent cited above of *In re Hoare & Co Ltd* (1934) 150 L.T. 374.
[192] In this regard the court referred to a judgment reported in the Indian Law Reports (1943) in the case of *Government Telephones Board Ltd v Harmusji Manekji Seervai.*
[193] *Sammel and Others v President Brand Gold Mining Co Ltd* 1969 (3) SA 629 (A): 670.
[194] *Sammel and Others v President Brand Gold Mining Co Ltd* 1969 (3) SA 629 (A): 671.
[195] *Sammel and Others v President Brand Gold Mining Co Ltd* 1969 (3) SA 629 (A): 672.

whole,[196] though it did concede that the information may have been relevant to the price offered.[197]

It was evident from the facts that the parties who had accepted the offer at that stage, were indeed informed, as parties to the contract to reconstruct, of most of the relevant information tabled. This, however, posed a next relevant question relating to the interest that the majority shareholders had in the take-over as a result of exactly this agreement.

7.4.4.6 A disinterested majority?

It was argued by the appellants that the nine tenth majority required in terms of section 103*ter*[198] should be made up of disinterested shareholders only. The recognition and enforcement of such an interpretation would undo the nine tenths majority gained and would avert the acquisition of the shares of the dissenting shareholders.

The court rejected this argument. It found that a pure construction of the legislative intention underlying the original section 103*ter*[199] did not support the contention that the required majority be disinterested.[200] The later insertion of a pre-condition relating to the transferor and/or his/her nominees altered that interpretation, but, in the opinion of the court, did not extend it to include the requirement that the 90% majority be an entirely disinterested one.[201]

7.4.4.7 The number of dissentients

In addition to other arguments not relevant to the realm of takeovers, the appellants finally argued that the number of dissentients, as opposed to their shareholding should be indicative of the fairness of the scheme.

Though the number of dissentient shareholders in this instance actually outnumbered the shareholders who did accept the take-over offer, the court held the fact to be irrelevant in the case. It did, however, concede that the court was entitled to take such a fact into consideration in as far as it relates to the fairness of the scheme or contract.

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[196] *Sammel and Others v President Brand Gold Mining Co Ltd* 1969 (3) SA 629 (A): 675.
[197] *Sammel and Others v President Brand Gold Mining Co Ltd* 1969 (3) SA 629 (A): 674.
[198] Companies Act 46 of 1926.
[199] Companies Act 46 of 1926.
[200] *Sammel and Others v President Brand Gold Mining Co Ltd* 1969 (3) SA 629 (A): 688.
[201] *Sammel and Others v President Brand Gold Mining Co Ltd* 1969 (3) SA 629 (A): 691.

7.4.4.8 Conclusion

The appeal failed with costs and no other order was granted to the dissenting shareholders. In this judgment, however, considerations, that are still utilised by our courts to evaluate the fairness of a take-over scheme, when approached by a dissenting minority seeking an order to escape the statutory dispossession of their shares, were crystallised. In formulating these criteria, the Appellate Division drew on judgments delivered on similar provisions applicable in jurisdictions as far afield as India and Canada.

What does emerge clearly from this judgment, however, is that the court regards itself as the guardian of minority interests through its power to order that the provisions of such sections as 103*ter*, the repealed section 321 and the current section 440K not be applied.

7.5 The dispensation prior to the promulgation of the Securities Regulation Code on Takeovers and Mergers

7.5.1 Listed companies

The Van Wyk de Vries Commission envisaged a large scope of involvement for the Johannesburg Stock Exchange in the regulation of takeovers and mergers:

> 'From our examination of most take-over bids involving listed shares in South Africa, we can see no reason why the Johannesburg Stock Exchange should not be regarded as an important mechanism for supervising these takeovers ...
>
> If the [Companies] Act were to provide a framework of principles to govern takeovers generally, the Stock Exchange would be able to create requirements to insure compliance with the law and at the same time for regulating an orderly procedure securing fair dealing in the interests of shareholders and the public.'[202]

Prior to the promulgation of the Securities Regulation Code on Takeovers and Mergers, the Johannesburg Stock Exchange maintained sets of rules, requirements and a procedure for listing, as it still does.

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[202] Republic of South Africa1972:par 73.09.

In the case of *Dawnlaan Beleggings (Edms) Bpk v Johannesburg Stock Exchange and Others*[203] the applicant relied on the 'principle of equal opportunity' namely that the transfer of control of a listed company would not be approved by the Committee of the Johannesburg Stock Exchange unless the offeror undertook to make a comparable offer to the holders of the remaining equity share capital.

This principle was contained in the following rule of the stock exchange:-

> 'Directors whose shareholdings together with hose of their families, trust and private investment companies, directly or indirectly effectively control a company, or shareholders in that position who are represented on the board of a company, and who contemplate transferring control must not other than in special circumstances, do so unless the buyer undertakes to extend within a reasonable period of time a similar offer to the holders of the remaining equity share capital, whether such capital carries voting rights or not.'

The court, upon a proper consideration of the facts, made the following finding in this regard:-

> '[T]he effect of the principle of equal opportunity of participation by minority shareholders meant that a person wishing to purchase control of a listed company, when making an offer to shareholders, was required to take all shareholders into account. An 'across-the-board' offer has to be made to all the shareholders.'[204]

And

> '[T]he principle of equality was designed to ensure that, in the absence of extraordinary circumstances, the JSE should not approve the change of control when an offer is made to shareholders unless all of the shares are treated equally. As the applicant points out, non-voting shares are presumably purchased on the market on the basis and implicit understanding that this principle of equality of treatment will be enforced, save in exceptional circumstances.'[205]

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[203] 1983 (3) SA 344 (W).
[204] *Dawnlaan Beleggings (Edms) Bpk v Johannesburg Stock Exchange and Others* 1983 (3) SA 344 (W):366.
[205] *Dawnlaan Beleggings (Edms) Bpk v Johannesburg Stock Exchange and Others* 1983 (3) SA 344 (W):368.

7.5.2 Unlisted Companies

The transaction under examination in *United Trust (Pty) Ltd v South African Milling Company*[206] was not one dealing in listed shares and consequently not subject to the approval of the Johannesburg Stock Exchange. The judgment on the general duties of majority shareholders in transactions for the sale of their shareholding, without the knowledge of the minority shareholders, was summarised as follows:-

> 'if the majority of shareholders in a company sell their shares to a third party, their action can only be impeached if they receive a larger price at the expense of other shareholders. If the majority sell their control to a third party the minority is in exactly the same position as it was before the sale, except that the control is now to be exercised by B in stead of A. The position is different if the action of the majority is fraudulent, in the sense in which that word is used in regard to the oppression of the minority, but in the absence of that essential the majority must be entitled, without hindrance, to sell their shares as a block at the best price they can obtain for those shares.'[207]

This judgment serves as a clear indication that the principle of equal opportunity does not enjoy general application in South African Company Law.

7.6 The Securities Regulation Code on Take-overs and Mergers

The Securities Regulation Code on Takeovers and Mergers enjoys application in terms of section 440L of the Companies Act,[208] which prohibits entering into, or even proposing, an affected transaction except in terms of the rules contained in the Code. The Code was compiled by the Panel in terms of section 440C(3) and was approved by the Deputy Minister of Trade and Industry and National Education. It came into effect on 1 February 1991. It is currently in the process of revision.[209]

The Code, as promulgated, represents the collective opinion of the parties professionally involved in the field of takeovers and mergers, not only as to acceptable business standards, but also as to how fairness to the holders of the relevant securities may be achieved.[210] The

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[206] 1959 (2) SA 426 (W).
[207] *United Trust (Pty) Ltd v South African Milling Company* 1959 (2) SA 426 (W).
[208] Companies Act 61 of 1973.
[209] Anonymous 2000:2.
[210] Explanatory notes to the Securities Regulation Code on Takeovers and Mergers.

Code operates principally to ensure the fair and equal treatment of all holders of securities relevant in affected transactions as defined in both the Act and the Code.[211]

The Code comprises four main parts, namely:-

a) The Introduction, as contained in Section A;

b) Definitions in Section B;

c) General Principles embodied in Section C;.[212] and

d) the Rules contained in sections D through R, which make provision for:-

   i) the regulation of all transactions and schemes which constitute 'affected transactions' as defined and also those proposals, which will, upon implementation, be affected transactions;

   ii) the duties of both the offeror and offeree in such affected transactions; and

   iii) appeals from the decisions of the Executive Director to the Executive Committee, the decisions of the Executive Committee to the Panel, and decisions from any sub-committee of the Panel to the Panel itself.

It is evident from the Explanatory Notes to the Code that the principles of equality and of equal opportunity are the dominant standards in its regulatory practice,[213] and its specific inclusion in the General Principles in various forms, and in Section F in its specific application, will be examined below.

7.6.1 General principles

A set of basic principles underlie the Securities Code on Takeovers and Mergers. These principles were compiled by the drafters of the code due to the fact that it would be unpractical to regulate take-overs and mergers through rules in adequate detail.

In this manner persons involved in affected transaction should heed not only the formal rules as stated, but also the spirit of the basic principles and their exact wording. Where circumstances are not completely provided for in the rules, these basic principles and the spirit of the code will be applicable.[214]

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[211] Explanatory notes to the Securities Regulation Code on Takeovers and Mergers. See also Luiz 1997:239.

[212] The General Principles constitute a codification of the acceptable standards of commercial behaviour and have, in terms of Section A: 2 of the Code, an obvious and universal application. In terms of Section A: 1 of the same, the Introduction, Definitions and General Principles are as binding as the remainder of the Code and are intended to serve as an amplification of the rules contained in the Rules proper.

[213] These principles are referred to in paragraphs 1, 10 and 11 of the General Principles of the Code, Section F on the Mandatory Offer, Section H: Rule 12(a), Section H: Rule 13 and Section H: Rule 16.1.

[214] Securities Regulation Code on Takeovers and Mergers Section C:1

The general principles are as follows:-

7.6.1.1 All holders of the same class to be treated equally

All holders of the same class of securities of the target company must be treated equally by the offeror.[215]

7.6.1.2 Information to be available to all holders of relevant securities

During the course of an offer, or when an offer is under consideration, neither the offeror, nor the prospective offeror, nor the offeree company or their advisors, may furnish information to selected holders of relevant securities if that information is not also available to all holders of securities. The exception to this rule occurs when consent is given by the Securities Regulation Panel.[216]

7.6.1.3 Careful and responsible consideration before announcing offer

The most careful and responsible consideration is required of the offeror before it announces and offer or its intention to make one. Only when the offeror believes that it can and will continue to implement such an offer, may the announcement be made.[217]

7.6.1.4 Sufficient information, advice and time required for consideration of offer

No relevant information may be held from the holders of securities and the offeror must afford them sufficient advice, time and information to reach a properly informed decision.[218]

7.6.1.5 Standards of care and accuracy in documents to holders of relevant securities

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[215] Securities Regulation Code on Takeovers and Mergers Section C:2.1; Gibson 1997: 402; Meskin 1994:962; . Cilliers et al 1992: 460.
[216] Securities Regulation Code on Takeovers and Mergers Section C:2.2; Gibson 1997: 402; Meskin 1994:962; . Cilliers et al 1992: 460.
[217] Securities Regulation Code on Takeovers and Mergers Section C:2.3; Gibson 1997: 402; Cilliers et al 1992: 460.

In the same standard required of the prospectus of a company, documents or advertisements addressed to the holders of relevant securities, containing information or advice from the offeror or its board or advisors, must be prepared with the highest standards of care and accuracy.[219]

7.6.1.6 Care to prevent false market

Parties to offers must take care to avoid making statements which will mislead the holders of securities or create a false market in the securities of either the offeror or the offeree company.[220]

7.6.1.7 Attempt by offeree's directors to frustrate bona fide *offer*

Once a bona fide offer has been communicated to the board of the offeree company, or after such board has reason to believe that a bona fide offer is in the making, the board may take no steps not approved by the shareholders, lest they frustrate the offer or deprive such holders of securities of the opportunity to make a decision on the merit of the offer.

7.6.1.8 Rights of control to be exercised in good faith

The principle that the minority shareholders may not be oppressed is also contained in the Securities Regulation Code as a general principle.

7.6.1.9 Directors to act in terms of their fiduciary duties

Directors of both the offeror and the target companies are bound to act in their capacities as directors and may not allow themselves to be swayed by personal shareholding, family shareholding, or their personal relationships with the company. In advising the holders of securities, they are bound to advise the members of the company as a whole and not any single shareholder.[221]

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[218] Securities Regulation Code on Takeovers and Mergers Section C:2.4; Gibson 1997: 402; Cilliers et al 1992: 460.
[219] Securities Regulation Code on Takeovers and Mergers Section C:2.5; Gibson 1997: 402; Cilliers et al 1992: 461.
[220] Securities Regulation Code on Takeovers and Mergers Section C:2.6; Gibson 1997: 402;. Cilliers et al 1992: 460.
[221] Securities Regulation Code on Takeovers and Mergers Section C: 2.9; Gibson 1997: 403; Ciliers et al 1992:461.

7.6.1.10 Mandatory offer where change of control

The principle entrenched in this provision places an obligation on the offeror to ensure, prior to launching the bid, that, should he/she incur the obligation to make the mandatory offer, he/she is able to do so.[222]

7.6.1.11 Disposal of an equity interest comparable to an affected transaction

The principle underlying these provisions is that a person disposing of his/her equity interest is entitled to dispose of that interest in circumstances comparable to that in an affected transaction in the relevant securities.[223]

The notion of equality runs like a golden thread through these general principles. [224] The offer to each holder of a security in a particular class of securities should be no different from the offer to each other holder of a security in such class.[225] Each such holder should (ordinarily) be furnished with the same information as each other such holder[226] and the holders of securities in an offeree company constituting a minority as a result of the implementation of an affected transaction should be entitled to dispose of their securities on terms comparable to those of the initial sellers.[227]

It is submitted that, to a significant extent, these principles culminate and find practical application in the mandatory offer required in terms of Rule 8 of the Code. The mandatory offer and its terms and requirements, as well as a recent judgment on the rule will be examined in detail with specific regard to the application of the principle of equal opportunity to shareholders of the offeree company.

7.6.2 Section F: The mandatory offer and its terms

The obligation to make the mandatory offer in terms of Rule 8 of the Securities Regulation Code arises upon acquisition of securities that carry the specified percentage of the voting

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[222] Securities Regulation Code on Takeovers and Mergers Section C 2.10; Gibson 1997: 403; Cilliers et al 1992:461.
[223] Securities Regulation Code on Takeovers and Mergers Section C: 2.11; Gibson 1997: 403; Meskin 1994: 692; Cilliers et al 1992:461.
[224] Meskin 1994:962.
[225] Securities Regulation Code on Takeovers and Mergers Section C:2.1.
[226] Securities Regulation Code on Takeovers and Mergers Section C:2.2.
[227] Securities Regulation Code on Takeovers and Mergers Section C:2.11; Meskin 1994:962.

rights in the offeree company, or upon the acquisition of securities that carry 5% or more of the voting rights in a company by any person already in possession of more than the specified percentage,[228] but not more than 50% of the securities in the offeree company.[229] The mandatory offer must be made to:-

a) the holders of any class of equity capital, whether voting or non-voting; and

b) to the holders of any class of non-voting equity capital;

of which the agitator or persons acting in concert with him/her, are holders and the offer must be to acquire their securities for the same or comparable consideration.[230] Not only is this obligation incumbent upon the offeror, but also on each member of a group of persons acting in concert with the offeror.[231]

The mandatory offer may be made irrespective of whether or not the implementation of either such an offer, or the initial acquisition, would be dependant upon the passing of a resolution at a shareholder meeting of the offeror, provided these terms are clearly communicated to all affected parties.[232]

The mandatory offer must be made in respect of each class of securities involved for the same consideration as was operative during the relevant acquisition. In addition, where applicable, the offer must be accompanied by a cash alternative equivalent to, or higher than, the highest price paid by the offeror or any person acting in concert with him/her,[233] for securities in the preceding three months.[234] This offer must remain open for a period of 14 days after it becomes or is declared unconditional as to acceptances, after the date on which it would otherwise have expired.[235] In instances where there is more than one class of security involved, the Panel must be consulted.[236]

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[228] The specified percentage is currently set at 35% in terms of Section B: 5 of the Securities Regulation Code on Takeovers and Mergers.

[229] Securities Regulation Code on Takeovers and Mergers Section F: Rule 8.1.

[230] Offers for different classes of equity capital shall be comparable and the panel shall be consulted in advance in such cases.

[231] Securities Regulation Code on Takeovers and Mergers Section F: Rule 8.2.

[232] Securities Regulation Code on Takeovers and Mergers Section F: Rule 8.3.

[233] If the offeror is of the opinion that the highest price should not be paid in any particular instance, the offeror must consult the Panel. The Panel may, in its discretion, consent to an revised price. Securities Regulation Code on Takeovers and Mergers Section F: Rule 8.4(b).

[234] The commitment to securing the highest price paid for securities in an affected transaction for the remaining shareholders also appears from Section E: Rule 5 where the most favorable consideration, or highest price is guaranteed in respect of acquisitions made prior to the offer period and acquisitions above the offer price. In both instances the holders of relevant securities will become entitled to the most favourable consideration in order to give effect to General principle 1 as discussed above.

[235] Any offer must remain open for at least 14 days after the date on which it has either become, or been declared, unconditional as to acceptances. Securities Regulation Code on Takeovers and Mergers Section M: Rule 28.4.

[236] Securities Regulation Code on Takeovers and Mergers Section F: Rule 8.4.

Where the directors of the offeree company will trigger the mandatory offer by the sale of their own shares, the undertaking of the purchaser to make this mandatory offer, must be included in the conditions of sale. In addition, the directors are required to remain in office until such a time as the offer closes or until the date upon which the offer either becomes or is declared unconditional.[237]

7.6.2.1 When it is required and who is primarily responsible for making it

7.6.2.1.1 The acquisition of securities

In terms of the Code, the term 'acquisition' means the acquisition of shares or other securities in a company by any means whatsoever, including the acquisition of shares by purchase or subscription.[238]

Generous interpretation of the term within in this context would recognise that:-

> 'It consists of a series of steps, namely an agreement to transfer, the cession of the rights attaching to the share, the execution of a deed of transfer, the delivery of the deed of transfer and the share certificate to the transferee, and, finally, the registration by the company of the transfer. On registration of the transfer, the transferor ceases to be and the transferee becomes, a member of the company in right of the share, with the rights and obligations attaching to shareholding and membership.'[239]

The courts have varied views on the meaning of the terms 'acquire' and 'acquisition'. In the judgment in *Transvaal Investment Co Ltd v Springs Municipality*[240] the court recognised that the term not only denotes the acquisition of ownership of property, but also the acquisition of a right to ownership under an agreement of purchase and sale.[241] Likewise, the court construed that the term 'acquiring', as used in section 3 of Ordinance 12 of 1906 (ORC), also included the acquisition of a right to acquire ownership in the case of *Minister of Finance v Gin & Goldblatt*.[242] In addition, a wide meaning was given to the term 'acquire' as used in section 2 of the Transfer Duty Act, in the case of *Secretary for Inland Revenue v*

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[237] Securities Regulation Code on Takeovers and Mergers Section F: Rule 8.5.
[238] Companies Act 61 of 1973: S 440A. Securities Regulation Code on Takeovers and Mergers Section B.
[239] Blackman 1996: par 225.
[240] 1922 AD 337.
[241] *Transvaal Investment Co Ltd v Springs Municipality* 1922 AD 337: 341.
[242] *Minister of Finance v Gin & Goldblatt* 1954 (3) SA 881 (AD): 884.

Hartzenberg.[243] The term was held to include the acquisition of a personal right to acquire property.[244]

The term 'acquire' as used in Rule 8.1 has been given a wide meaning.[245] A mere agreement to purchase share has been construed as an acquisition sufficient to warrant the making of the mandatory offer.

7.6.2.1.2 The securities so acquired

The term 'security' is defined so as to include any shares in the capital of a company, including:-

a) stock and debentures convertible into shares;
b) any rights or interests in respect of a company or in respect of any such shares;
c) stock;
d) debentures; and
e) and 'financial instrument' as defined in the Financial Markets Control Act 55 of 1989.[246]

The courts have held that a share in a company comprises a collection of claims entitling the holder thereof to a certain interest in the company, its assets and dividends.[247] Thus the court have, on occasion, afforded a generous interpretation to the term 'security.'

7.6.2.1.3 *Haslam and Others v Sefalana Employee's Benefit Organisation*

Though judgments on Rule 8.1 are scarce, the case of *Haslam v Sefalana*[248] did afford the court an opportunity to examine the provisions of the rule and to expound upon the spirit and purpose of the provision.

The particular question isolated by the court relates to the circumstances in which the offeror is required to extend an offer for the purchase of shares to the minority shareholders in the offeree company,[249] most specifically, when an offeror 'acquires' shares in a company and whether or not a valid agreement to buy a controlling shareholding, triggers the mandatroy offer, even if subsequently repudiated.

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[243] 1966 (1) SA 405 (A).
[244] *Secretary for Inland Revenue v Hartzenberg* 1966 (1) SA 405 (A): 409.
[245] *Haslam v Sefalana Employee's Benefit Organisation* 1998 (4) SA 964.
[246] Securities Regulation Code on Takeoves and Mergers Section B.
[247] *Botha v Fick* 1995 (2) SA 750 (AD): 762; *Randfontein Estates Ltd v The Master* 1909 TS 978:981.
[248] *Haslam v Sefalana Employee's Benefit Organisation* 1998 (4) SA 964.
[249] *Haslam v Sefalana Employee's Benefit Organisation* 1998 (4) SA 964:966.

7.6.2.1.3.1 The facts

The Sefalana Employee's Benefit Organisation agreed to purchase from Concor Holdings (Pty) Ltd its shareholding of 66% in Time Life Insurance Limited, which had given it effective control of that company at an agreed price or R 2,50 per share.

Had the transaction been effected in the manner provided by these parties, the transaction would fall within the scope of the term 'affected transaction' as explained above and would incur upon the offeror all the obligations so intended in terms of the Securities Regulation Code. These obligations would include obligation to make the mandatory offer to acquire the shares of the remaining minority in terms of Rule 8.1.

Prior to the transfer of the shares held by Concor Holdings (Pty) Ltd, the defendant in this action repudiated the agreement. Concor accepted the repudiation and claimed damages in respect of the breach of contract, a claim which Sefalana Employee's Benefit Organisation admitted.

As a result of the cancellation of the contract, Sefalana Employee's Benefit Organisation did not make the mandatory offer for the purchase of the shares of the minority. Due to the breach of contract, however, these shareholders alleged that the value of the shares had dwindled to almost noting, and consequently they instituted action to claim their damages based on the failure of Sefalana to make this offer.

7.6.2.1.3.2 The application of relevant legislation to the facts

The first critical question isolated by the court related to whether or not the agreement concluded between Concor and Sefalana Employee's Benefit Organisation constituted an 'acquisition' of 'securities'.[250] In applying the relevant definitions, the court considered the spirit and purport of the Securities Regulation Code, isolating and categorising the applicable principles from the general principles:-

a) the weighty consequences of making an offer:[251]

3) An offeror shall only announce an offer or its intention to make one after the most careful and responsible consideration. Such an announcement shall only be made when the offeror has proper grounds for believing that it can and will continue to implement the offer;[252]

10) An affected transaction normally gives rise to an obligation to make a general offer to all other holders of the relevant securities. Where an acquisition is

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[250] *Haslam v Sefalana Employee's Benefit Organisation* 1998 (4) SA 964:969.
[251] *Haslam v Sefalana Employee's Benefit Organisation* 1998 (4) SA 964:970.
[252] Securities Regulation Code on Takeovers and Mergers Section C:2.3.

contemplated as a result of which a person may incur such an obligation, he shall, before making the acquisition, ensure that he is and will continue to be able to implement such an offer;[253]

b) the equal opportunity principle:[254]

1) all holders of the same class of securities of an offeree company shall be treated similarly by an offeror;[255]

11) persons holding an equity interest in an offeree company through shares or other securities in that company (whether or not such carry voting rights) shall be entitled to dispose of that interest on terms comparable to those of any affected transaction in the relevant securities.[256]

The court also referred to the somewhat narrow scope of the applicable provisions as they stood prior to the 1991 introduction of the Securities Regulation Code and drew from the shift in application the conclusion that the clear intention of the Code is to cover a much wider ambit of dealings that the preceding legislation.[257]

As to the meaning of the term 'acquisition', the court considered the following three possible interpretations:-

a) the ordinary legal meaning according to which the acquirer becomes owner;[258]

b) the acquisition of a right to obtain ownership;[259]

c) that, in the absence of a statutory definition to the contrary, the stricter interpretation is to be preferred.[260]

In its evaluation of the statutory provisions thus applicable, the court refers to the wide definition of the term 'security' which includes rights or interests in respect of shares. From this, the court concludes that the narrow definition of the term 'acquisition' is defeated and that the actual transfer of the shares was irrelevant.[261]

The court specifically referred to the fact that the would-be offeror never acquired control of the would-be offeree, but found in its overall appreciation of the rules, principles and definitions of both Chapter XVA[262] and the Securities Regulation Code on Takeovers and

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[253] Securities Regulation Code on Takeovers and Mergers Section C:2.10.
[254] *Haslam v Sefalana Employee's Benefit Organisation* 1998 (4) SA 964:970.
[255] Securities Regulation Code on Takeovers and Mergers Section C:2.1.
[256] Securities Regulation Code on Takeovers and Mergers Section C:2.11.
[257] *Haslam v Sefalana Employee's Benefit Organisation* 1998 (4) SA 964:971.
[258] *Transvaal Investment Co Ltd v Springs Municipality* 1922 AD 337:341.
[259] *Corondimas and another v Badat* 1946 AD 548:558.
[260] *Haslam v Sefalana Employee's Benefit Organisation* 1998 (4) SA 964:971.
[261] *Haslam v Sefalana Employee's Benefit Organisation* 1998 (4) SA 964:972.
[262] Companies Act 61 of 1973.

Mergers, that the minority shareholders should enjoy fair and equal treatment through the invocation of the mandatory offer.[263]

7.6.2.1.3.3 Conclusion

The court acknowledged, in the first instance, that the Securities Regulation Code on Takeovers and Mergers is directed, not at aborted takeovers, but at transactions in which control passes to the offeror. Notwithstanding this, Cameron J found that, on a proper interpretation of the Code, the principle of the equal treatment of shareholders, which lay at the heart of the Code, entitled the minority shareholders to the relief they claimed. In this manner the court, in its own words, allowed the dissenting minority to 'leap onto the bandwagon that SEBO's admitted breach of its agreement with Concor ... created.'[264]

Sefalana Employees Benefit Organisation was accordingly ordered to make the mandatory offer to the remaining shareholders.

This decision was, however, not upheld on appeal.

7.6.2.1.4 *Sefalana Employees Benefit Organisation v Haslam and Others*

The issue in this appeal, was described by the court to be as novel as it is narrow:[265]

> 'May shareholders in a company to whom a mandatory offer to purchase their shares would have had to be made if a transaction with another shareholder has resulted in the purchaser acquiring control of the company, sue for damages if no such offer is forthcoming because the purchaser repudiated the transaction, the selling shareholder accepted the repudiation and successfully claimed damages and the purchaser did not acquire control of the company?'

7.6.2.1.4.1 The arguments before the court

On appeal, the appellants argued that the provisions of the Code be interpreted restrictively in deference to the prohibitive cost that would be incurred by any offeror, should the obligation to purchase the shares of the 'minority' shareholders be enforced in any given set of facts.

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[263] *Haslam v Sefalana Employee's Benefit Organisation* 1998 (4) SA 964:974.
[264] *Haslam v Sefalana Employee's Benefit Organisation* 1998 (4) SA 964:973.
[265] *Sefalana Employees Benefit Organisation v Haslam and others,* unreported judgement delivered 03 March 2000 by the Supreme Court of Appeal, case no 553/97:2.

In addition, it was argued, the issue of minority protection only becomes relevant in these circumstances, where control has indeed passed to the offeror. Only when this transfer of control has been completed, does the minority come into existence.

The respondents, in turn, argue for a generous interpretation of the provisions of the Code based on the obvious emphasis on equality of treatment. The majority shareholders in this case were awarded damages[266] for the offeror's breach of contract, and it was argued that the same consideration be extended to the minority, on these grounds.

7.6.2.1.4.2 Equality of treatment

At the outset the court established that shareholders are not ordinarily entitled to equality of treatment in offers for the purchase of their shares. Only once the intended or proposed transaction will result in a transfer of control does the provision relating to the Securities Regulation Panel and the Rules contained in the Securities Regulation Code become applicable.[267]

Should such a transaction be proposed, it does not necessarily follow that the mandatory offer must be made regardless of whether the mentioned transaction does indeed take place. In support of this, the court refers to the salutary practice of testing the proposed construction by applying it to the situation. Should such an exercise produce startling results, it can become clear that the proposed construction is not correct.

In the given facts, the sole rationale for the obligation to make the mandatory offer falls away: those shareholders who would have been in jeopardy of finding themselves locked into a company of which the control has changed without their concurrence is no longer in such jeopardy and the mischief which the relevant provisions were enacted to counter, no longer exists.[268]

Though the court recognised the superficial appearance of inequality of treatment, it differentiated between the positions of the majority and minority shareholders on the following grounds: the majority shareholder had an unconditional agreement to purchase shares with the offeror, whereas the offer to the minority shareholders in terms of the statutory provisions were conditional upon the acquisition of control by the offeror.

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[266] Section 440 M of the Companies Act 61 of 1973 makes provision for damages to be awarded to any person who suffers such damages from any person's contravention of the rules imposed in terms of this Chapter.

[267] *Sefalana Employees Benefit Organisation v Haslam and others,* unreported judgement delivered 03 March 2000 by the Supreme Court of Appeal, case no 553/97:6.

7.6.2.1.4.3 Conclusion

The principle of equality of opportunity in affected transactions was not disputed. Its application to situations where control did not actually pass to a new controlling shareholder, was, and was rejected. In this manner, the Supreme Court of Appeal limits the application of the principle to the arena for which it was legislatively intended: it is a measure designed to protect dissenting minority shareholders from an incumbent management to which they did not consent and whom they could not restrain from the company because they were not in the majority.

7.6.2.2 The view of the Standing Advisory Committee on Company Law on the mandatory offer

It should be noted that the mandatory offer has incurred, if not the wrath, then certainly the reformatory attention of the Standing Advisory Committee. In a press statement released by the Department of Trade and Industry on behalf of the Chairman in 1997, submissions were requested on the retention of the requirement of a mandatory offer to minority shareholders in a takeover situation.

In recognition of the minority protection underlying the obligation, the SAC advanced the following argument in favour of the current provisions as discussed above:-

a) shareholders should not be forced to become minority shareholders in a company without being afforded the opportunity of selling their shares;
b) minority shareholders under one majority regime should not be compelled to remain such under a different regime;
c) company 'looters' whose sole aim in the acquisition of control of a company is the stripping of its assets, may possibly be deterred by the high cost of such an acquisition under the circumstances.

The following arguments against the retention of the mandatory offer were likewise tendered:-

a) the protection afforded by the measure is not absolute as the party seeking control may well employ methods enabling him/her to gain control without incurring the obligation;
b) the financing of takeovers are made exceedingly expensive due to the fact that the offeror must purchase not only the shares required to gain effective control, but also those of any dissenting minority;

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[268] *Sefalana Employees Benefit Organisation v Haslam and others,* unreported judgement delivered 03 March 2000 by the Supreme Court of Appeal, case no 553/97:9.

c) this excessive cost hampers black empowerment attempts in the South African context; and

d) company looters will not necessarily be discouraged by this measure as asset-stripping decisions are taken upon the asset value of the company and weighed against the total cost, which may well include (and outweigh) the cost of the mandatory offer.

The criticism of the rule appears to be specific to the South African developmental context. The mandatory offer will most likely have the effect that the offeree will be compelled to purchase more shares than is required to obtain control of a company, thereby incurring additional expenditure in furthering empowerment objectives.

7.6.2.3 Obligations of other persons

Not only the offeror is compelled to make the mandatory offer to minorities once the specified percentage shareholding of 35% is reached, but each of the members of a group acting on concert with him/her, share this obligation to make an offer, though with reference to the circumstances of the case.[269]

7.6.2.4 Conditions and consents

If the acquisition of securities which would trigger the obligation to make the mandatory offer is dependant on the passing of a resolution at a meeting of the shareholders of the offeror, that offer may be made notwithstanding that fact or any other such condition, provided that all relevant parties are informed of those conditions.[270]

7.6.2.5 Consideration to be offered

As discussed above at 7.6.1.10, the consideration to be offered to the dissenting shareholders must the same as was operative under the relevant acquisition.[271] Exemption from this duty may be obtained after consultation with the Securities Regulation Panel, which may consent to an adjusted price.[272]

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[269] Securities Regulation Code on Takeovers and Mergers Section F: Rule 8.2.
[270] Securities Regulation Code on Takeovers and Mergers Section F: Rule 8.3.
[271] Securities Regulation Code on Takeovers and Mergers Section F: Rule 8.4(a).
[272] Securities Regulation Code on Takeovers and Mergers Section F: Rule 8.4(b).

7.6.2.6 Obligations of directors selling securities

In instances where the majority of shareholders consenting to the takeover as proposed, are directors of the offeree company, they must secure, as a condition to the sale of their own shares, that the offeror must make the mandatory offer to the remaining shareholders. In addition, they may not resign from their positions as directors until such a time as the offer becomes unconditional.[273]

7.6.2.7 Restrictions on exercise of control by an offeror

The offeror is restricted from exercising any votes attached to securities held in the offeree company and from appointing a nominee of the offeror; or persons acting in concert with the offeror to the board of the offeree prior to the posting of the offer document.[274]

Such an offer document is posted within 30 days of the announcement of a firm intention to make an offer[275] and contains the reasons for the offer and its intentions regarding the continuation of the business of the offeree company and the continuation in office of the directors of the offeree company.[276]

7.6.2.8 Vote of independent holders of securities on the issue of new securities

The Panel is empowered to suspend the obligation to make the mandatory offer in instances where new securities to be issued are offered as consideration for an acquisition, when such a consideration in cash would normally have triggered the obligation. Normally, the Panel will dispense with the obligation if it is waived by means of a majority vote when cast:-

a) at a properly constituted meeting of the holders of the relevant securities;
b) by an independent majority;
c) if the case involves the underwriting of securities.

The Panel may also dispense with the requirement of the mandatory offer in cases where the approval of independent votes to the transfer of existing securities from holder to another is obtained.

In cases where a group of persons acting in concert come to control more than 45% of the voting rights in any company through such an action, thereby acquiring the ability to acquire

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[273] Securities Regulation Code on Takeovers and Mergers Section F: Rule 8.5.
[274] Securities Regulation Code on Takeovers and Mergers Section F: Rule 8.6.
[275] Securities Regulation Code on Takeovers and Mergers Section M: Rule 27.1.

less than 5% and so gaining control, without incurring the mandatory offer obligation, the offer document must specifically refer to that possibility.

Notwithstanding any of the provisions, the Panel will not suspend the obligation if the issuing of new securities is done in favor of a person who acquired relevant securities in the 12 months preceding the posting of the information in this regard to the relevant holders of securities, or if acquisitions are made independent of the offer and the meeting.

7.6.3 Section H: Provisions applicable to all offers

Several provisions contained in the Rules relating to provisions applicable to all offers, represent practical applications of the principles of equality and equal opportunity.

7.6.3.1 Comparable offers

The principle stated in Rule 8.1, namely that comparable offers be made in instances where a company has more than one class of security, regardless of whether such securities carry voting rights or not, is reiterated in Rule 11.1. Any offer for non-voting securities may not be made conditional upon the acceptance of such an offer by any specified percentage of holders, save for instances where the offer for voting securities is likewise conditional upon the acceptance of the offer for non-voting securities.[277]

7.6.3.2 Appropriate offer for convertible or other relevant securities

Equality of treatment is explicitly required in Rule 12(a) in instances where an offer is made for equity securities and the offeree company either has convertible securities outstanding, or other securities which, in substance, partake of the nature of equity. In such circumstances, the offeror is required to make offers to all such holder of convertible securities or holders of other relevant securities in order to safeguard their interests.[278]

7.6.3.3 Special deals with favourable conditions

In instances where there are favorable conditions attached to offers, neither the offeror, nor any persons acting in concert with him/her, may:-

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[276] Securities Regulation Code on Takeovers and Mergers Section J: Rule 21.1.
[277] Securities Regulation Code on Takeovers and Mergers Section H: Rule 11.1.

a) make any arrangements with with the holders of relevant securities; or

b) deal or enter into arrangements to deal in the securities of the offeree company; or

c) enter into arrangements which involve the acceptance of an offer,

when those favourable conditions are not extended to all holders of the relevant securities.[279]

7.6.4 Section I: Conduct during the offer

Rule 16.1 makes provision for the equal treatment of all shareholders through the regulation of equality of information to all holders of securities. Information relating to the companies involved in the relevant offer must be made equally available to all shareholders at the same time and in the same manner. The Panel alone may exempt an offeree from this obligation in instances where a confidential offer is made by a *bona fide* potential offeror or vice versa.

7.7 Section 440 K and Rule 8 compared

Section 440K and Rule 8.1 of the Securities Regulation Code on Takeovers and Mergers contribute seemingly similar mechanisms aimed at the protection of shareholders. The application of Rule 8.1, however, is regulated by reference to the voting rights carried by the securities involved, while the application of section 440 K is governed by reference to the number of relevant securities.

In addition, the level of shareholding which triggers the obligation to extend an offer to the remaining shareholders, differs vastly. The offer under section 440K is triggered at a level of 90% shareholding while the mandatory offer in terms of rule 8 is triggered at a mere 35%.[280] The key to this discrepancy seems to be located in the interpretation the court has given to the application of Rule 8 in the case of *Sefalana Employee's Benefit Organisation v Haslam and Others*, namely that the obligation is only triggered if the transaction involved is an affected transaction and that will only be the case if actual control of the offeree does pass to the offeror.

The mechanism, however, by which the protection of minority shareholders is brought about, agrees to a large extent, not only in the provisions of section 440K,[281] but also in the

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[278] Securities Regulation Code on Takeovers and Mergers Section H: Rule 12(a).
[279] Securities Regulation Code on Takeovers and Mergers Section H: Rule 13.
[280] The percentage set thus may be misleading, but must be understood within the context of the definition of an affected transaction. The ultimate result of the whole process of the purchase of shares will be that the offeror will assume control of the company. The specified percentage of 35 has only been set as one level within that process of acquiring control at which the offeror should extend the offer to the remaining holders of shares.
[281] Companies Act 61 of 1973.

provisions of Rule 8[282] and in the rules of the Johannesburg Stock Exchange: the principle of equal opportunity in takeovers and mergers, or more accurately, affected transactions.

In all the relevant provisions the similarity is to be found on a dual level. The same offer as is extended to the holder of the majority of the shares in a company, i.e. for the purchase of shares in the first place, is to be extended to all holders of relevant securities or securities of the same class – all shareholders must be afforded the same opportunity to sell their shares to the offeror. On the second level the offer must be for the purchase of such shares at the same consideration as that paid by the offeror to those shareholders who initially accepted the offer.

In each instance the obligation is statutory in nature and incumbent upon the offeror as a result of these statutory provisions. In South African law the obligation does not rest on the majority shareholders to secure for the remaining holders of shares the same advantaged resulting from the takeover as they secured for themselves, and the obligation is not a by-product of a fiduciary duty among shareholders. Nor is it the result of a formally recognised common law doctrine of equal opportunity.

Further inquiry into the principle as it developed in the Anglo-American jurisprudence is required in order to understand the origins of the principle and the *raison d'être* for the mandatory offer or mandatory bid.

7.8 Conclusion

It is quite evident that the notion of equality of treatment runs like a golden thread through all of the remedies especially designed for the protection of minority shareholders in affected transactions in South Africa.

The principle is contained in both section 440K and Rule 8.1 and is merely applied in different ways. In addition to the price-guarantee that is ensconced in section 440K, it also offers exactly what the mandatory bid offers the dissenting shareholders: an opportunity to end his/her membership of the company under new management.

A broader test of fairness is also provided by means of section 440K and our courts' interpretation of its provisions that offer the dissenting minority the opportunity to approach the court for a more equitable price or other solution to their dilemma.

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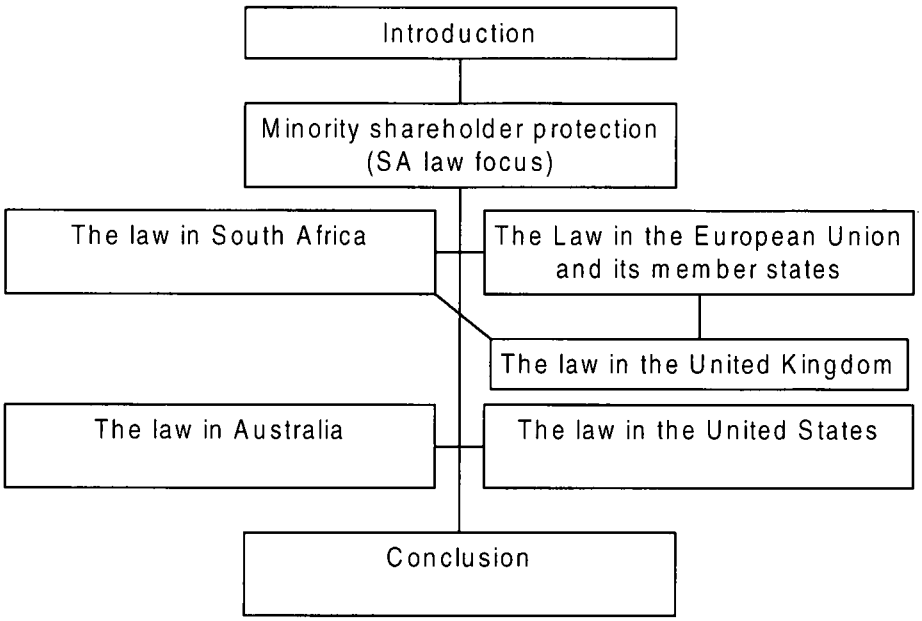
[282] Securities Regulation Code on Takeovers and Mergers.

It is clear from this analysis and that done in previous chapters, that South Africa's minority protection regime is on a par with that of other jurisdictions. In fact, South Africa adopted the mandatory bid as a statutory obligation far earlier than any of the jurisdictions studied here.

As is, however, the case in other jurisdictions, the mandatory bid is contentious. The Standing Advisory Committee has called for proposals on the abolition of the mandatory bid but, as yet, no steps have been taken to do so. It is submitted that the long, thorough and complicated processes surrounding the bid in other jurisdictions should serve as a marker to South African authorities not to simply discard the bid obligation.

It is also clear from the judgment of the Supreme Court of Appeal in *Sefalana Employees Benefit Organisation v haslam and Others*, that our courts will reserve the bid obligation for instances in which control actually passes to the offeror, thereby limiting it to the purpose for which it was intended.

OVERVIEW



The topic of this study is the protection of minority **shareholders** in affected transactions. As such is focusses on the protection of minority shareholders only in those **companies** to which the Securities Regulation Code is applicable. It examines the broad principles of minority shareholder protection – principally in South African law, but also briefly in the other jurisdictions concerned – and aims to show that none of these traditional doctrines are effective in affected transaction. The ultimate aim is to prove that only the principle of equality as it manifests in **equality of opportunity** to dispose of shares/benefit under the affected transaction at an **equal price** is an effective means of protecting minority shareholders and, as such, that the Standing Advisory Committee on Company law would be at fault to remove the mandatory bid from South African law.

This manifestation of equality is not only found in the mandatory bid which is examined in each of the jurisdictions concerned, but also in the compulsory acquisition provisions where a jurisdiction has such provisions in its companies act. These provisions normally also contain the 'out' provided by the mandatory bid and in addition, offer fair price protection to minority shareholders – simultaneously supplying majority shareholders with a mechanism to obtain 100% shareholding and its attendant benefits.

CHAPTER 8

CONCLUSION

8.1 Equal opportunity

The principle of equal opportunity stands central to the protection of the minority shareholders of the offeree company in affected transactions in the majority of the jurisdictions studied. This principle comprises two elements that are found to a greater or lesser extent in the mandatory bid provisions and compulsory acquisition measures in all of the jurisdictions studied, namely, an opportunity equal to that of the majority shareholders to sell shares and the opportunity to do so at the same price.

This study explored the possible origins of the principle of equal opportunity in all of the jurisdictions examined. The earliest authority for, and proposals in favour of, an equal opportunity rule, can be found in American law and most notably in the probing of fiduciary duties between shareholders.[1] Though the absence of fiduciary duty has been strenuously denied in Commonwealth jurisdictions, it is prominent in American case law.[2]

The presence of a fiduciary duty indicates an obligation to either protect or further the interest of the subject of the duty. From this broad duty stems a number of conjunctive duties such as those prominent in the law of partnership, especially in those jurisdictions in which partnership stems from contract.[3]

Minority shareholder protection was once viewed from the perspective that nay action not for the good of the company constituted a fraud on the minority. Yet British law derivative systems stop short of recognising a fiduciary duty incumbent upon majority shareholders in favour of the minority.[4] It is American jurisprudence that has imposed upon majority shareholders duties described as fiduciary duties to the minority. The may be clothed as fairness and becomes pivotal in situation such as contracts with the company, corporate opportunities and sales of control.[5]

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[1] See the dicussion at 3.2. See however the discussion on the development of the City Code on takeovers and Mergers at 4.3.1, which traces similar notions back to 1953. The recommendations of the Eggleston Committee in Australia date to 1969.
[2] Farrar 1993:384.
[3] Farrar 1993:384.
[4] Farrar 1993:388.
[5] Farrar 1993:395.

In the enforcement of this duty, the most appropriate remedy is frequently that the majority must buy the minority out at a fair value.[6]

It is, however, submitted that this notion no longer enjoys any support when it is viewed with the large publicly held corporation as blueprint.

American scholars also attempted to justify the notions contained in the principle from the perspective of control as a corporate asset, which belonged in equal part to all shareholders and the proceeds of which had to be evenly distributed among all shareholders, once sold.[7] This argument cannot be supported either.

While it is tempting to try and draw inferences of the kind drawn in *Perlman v Feldman*[8] and *Jones v HF Ahmanson & Co*[9] and in the South African and United Kingdom view of the fiduciary duties between shareholders in small private companies,[10] that such principles can be a foundation for the latter day application of the principle of equal opportunity, this is not possible with due recognition of the fact that takeover regulation is primarily applicable to publicly held companies and large private companies.

The only conclusion one can unquestionably reach on the origin and application of the principle of equal opportunity in the sale of shares, is that it is merely the primary mechanism for the protection of minority shareholders in transaction involving the sale of corporate control.

8.2 Universal mechanisms for the protection of minority shareholders in takeovers

This study has reviewed a number of shareholder protection mechanisms indigenous to the regulation of takeovers. The only remedies aimed at the protection of such shareholders in the offeror company, are those that are found in the American law relating to the appraisal remedy.[11] It is submitted that this is not minority protection of the kind required to ensure a sound environment for investor confidence. It is the minority shareholder in the target company who should enjoy protection.

It is submitted that there are two primary mechanisms aimed at the protection of those shareholders, namely the mandatory bid and the compulsory acquisition procedure.

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[6] Farrar 1993:396.
[7] See the discussion at 3.3.
[8] 219 F 2d 173, 175 (2d Cir). Cert denied, 394 US 952 (1955).
[9] 1 Cal 3d 93, 81 Cal Rptr 592, 460 P 2d 464 (1969).
[10] See the discussion at 2.5.
[11] See the discussion on the appraisal remedy at 3.7.

8.2.1 The mandatory bid

The mandatory bid is one of the most important shareholder protection mechanisms. The structure of this obligation is fundamentally the same in all of the jurisdictions studied,[12] save in Australia where the mandatory bid is an alternative method for effecting a takeover, rather than an independent protective obligation.[13]

It is not only to be found in the jurisdictions studied here, but also in a number of other jurisdictions that were not included in this study.[14] The converse is, however, also true. Many jurisdictions have no mandatory bid requirement.[15]

The bid presents a flexible structure and remarkable flexibility, rendering it relatively easily adaptable to the particular circumstances of the market in each jurisdiction.

8.2.1.1 Control

The first important aspect of the mandatory bid relates to notion of control and the level of shareholding at which control is acquired to an extent sufficient to trigger the obligation to make an across-the-board offer to all shareholders. While most jurisdictions have opted to set

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[12] See the discussion on the limited United States obligation in some states at 3.3.4, the United Kingdom obligation at 4.3.4, the obligation in terms of the proposed Thirteenth Directive at 5.3.4, and the South African obligation at 7.6.2.

[13] See the discussion at 6.6 and the conclusion on the nature of this form of the mandatory bid at 6.8.

[14] France has a mandatory bid obligation. In terms of the regulations of the Bourse and the Commission de Opèrations de Bourse, any person acquiring one third of the voting shares in a company is required to make a tender offer that would increase that shareholding to at least two-thirds of the voting shares. The law relating to companies was reformed with the passing of Law 98-545 in July of 1998 and a significant number of amendments were effected in relation to acquisition thresholds for the declaration of the number of shares held. Such declarations must now be lodged on acquisition thresholds of 5%, 10%, 20%, 33.3%, 50% and 66.6% calculated either by shares or by voting rights. In addition, the declaration made on the 10% and 20% thresholds should include a statement as to the intention of the acquirer for the following 12 month period. In particular the acquirer should indicate:-

a) whether he/she is acting alone or in concert with others;
b) whether he/she intends to acquire more shares or voting rights;
c) whether he/she intends to acquire control of the company; and
d) whether he/she intends to nominate himself/herself or any other person as a member of either the management or supervisory boards of the company.The threshold for the mandatory bid is set at 33%.

The Merger Rules in the Netherlands provides that, when a general bid is made, the same bid must be made to all the shareholders and must apply to all outstanding shares of the same type.

[15] Canada has no mandatory bid requirement, but does make provision for pro rate purchasing of shares in oversubscribed offers. See Hutson 2000:26 – 27; Courtright 1985:65 – 75; Robinson and Cannon 1980:63.

an exact numerical level of shareholding to control,[16] it is possible to refine these criteria so as to limit (and extend) the remedy to those situations for which it was intended.

Intrinsically linked to a shareholding requirement for control, is the definition of the affected transaction to which the code/act is applicable. The broader the definition of the transaction, the wider the protection offered to minority shareholders.

Should the definition of such a transaction, for instance include the sale of substantial part of the assets of the company involved, it may be necessary to re-examine setting a numerical level of control.

8.2.1.2 Persons acting in concert

Intrinsically linked with the notion of control is that of persons acting in concert to wield that control over the affairs of the company. While some jurisdictions have elected to fix the parameters applicable in relation to recognised corporate group structures, other jurisdictions have adopted guidelines more aptly suited to their own market and ownership structures.[17]

This adaptability renders the mandatory bid comparatively easy to adapt to the benefit of minority shareholders.

8.2.1.3 Consideration

As has been explained above, the protection afforded by the mandatory bid depends as much on an opportunity to exit the company under new control as on the price at which that opportunity is made available.

While some jurisdictions have developed and maintained strict safeguards for price maintenance by fixing the offer obligation at a price equivalent to the highest price paid in a preceding period,[18] other jurisdictions have opted for lower and more flexible price guarantees.

While such a reduction in price guarantee automatically reduces the protection the bid obligation extends to minority shareholders, it may well alleviate the criticism levied against the mandatory bid in respect of the resulting increase in the cost of takeovers.[19]

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[16] See for instance the United Kingdom, in which that level of shareholding was set at 30%.
[17] For a discussion on the difference in definition in the European Union, for instance, see 5.5.
[18] See, for example, the discussion on South African law at 7.6.2.5 compared to that of Austria discussed at 5.4.3.

8.2.2 The compulsory acquisition procedure

The compulsory acquisition procedure in most of the jurisdictions studied offers two safeguards for minority shareholders of which only one relates directly to the principle of equal opportunity.

8.2.2.1 Consideration

The first safeguard relates to the price at which the majority shareholder may acquire the shares of the remaining shareholders. This is much the same safeguard as was found in respect of the mandatory bid and was common to all of the jurisdictions studied, including the United States of America.[20] This construct is, of course, also to be found in other jurisdictions.[21]

Another aspect of the price safeguard is that in all of the jurisdictions studied, the offer must be for cash only, thus offering added protection in that shareholders may not merely be locked into another company.

Coupled with the right to demand the purchase of shares, this forms an important remedy that is slightly detracted from by the corresponding rights of expropriation effectively held by the majority shareholder in terms of the same provision.

8.2.2.2 The application to court

The second protective facet of the compulsory acquisition procedure undoubtedly relates to the right of dissenting shareholders to approach court for an order either determining different consideration or ordering that the compulsory acquisition not be effected.[22]

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[19] Empirical studies of takeovers agree that the share prices of targeted firms rise dramatically at the announcement of a takeover bid. See Ruback 1988:137.

[20] See the discussion on the law in the United Kingdom at 4.4, the discussion on Australian law at 6.7 and the discussion on South African law at 7.4.

[21] New Zealand, for instance, has a compulsory acquisition procedure outlined in section 208 of their Companies Act. The regulation of takeovers and mergers is vested in four sets of provisions:

a) the Stock Exchange Listing Rules;
b) Part 1 of the Companies Amendment Act 1963;
c) the Companies Acts 1955 and 1993; and
d) the Fair Trading Act 1986, section 9.

Though the 1955 Companies Act made provision for compulsory acquisition at 90%, the 1993 Companies Act contained no comparable provision. It was, at that stage, the stated view of the Law Commission that such provisions, if any, were to be contained in takeover legislation. See Brown 1992:211 – 215 and McKenzie 1996:428 – 432.

[22] See the discussion on the law in the United Kingdom at 4.4.3, the discussion on the law in Australia at 6.7.1.2 and 6.7.2 and the discussion on South African law at 7.4.3 and 7.4.4.

It is remarkable that the test set in those jurisdictions which founded their regulation on United Kingdom example, corresponds so closely to the test employed by American courts in the evaluation of the fairness of a takeover.[23]

It is submitted that the tests and guidelines that have been developed provide adequate protection for minority shareholders, with due recognition of the benefits attendant to full ownership of a corporate entity.

8.3 Possible reform of the mandatory bid

A multitude of arguments have been levied against the implementation or retention of the mandatory bid in a number of the jurisdictions studied.

More specifically in the South African environment, it has been submitted thatthe protection afforded by the measure is not absolute as the party seeking control may well employ methods enabling him/her to gain control without incurring the obligation.

It was also argued that the financing of takeovers are made exceedingly expensive due to the fact that the offeror must purchase not only the shares required to gain effective control, but also those of any dissenting minority and that this excessive cost hampers black empowerment attempts in the South African context.

In recognition of the minority protection underlying the obligation, however, it was also recognised that shareholders should not be forced to become minority shareholders in a company without being afforded the opportunity of selling their shares and that minority shareholders under one majority regime should not be compelled to remain such under a different regime.

It seems apt to explore the possible replacement of the bid obligation with an alternative regime, the total abolition of the bid and possible amendments to the bid in order to address the concerns forwarded while maintaining the advantages already recognised. One such alternative is the 'proper business purpose' test that is applied in the United States of America in relation to transactions that could amount to 'freeze-outs' of minority shareholders in the corporations concerned.

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[23] See the discussion on United States law at 3.6 and compare it against the following factos in South African law, set out in 7.4.4: The court also recognised that special circumstances may be put forward refuting this *prima facie* case, such as misrepresentation, which possibly

8.3.1 Replacing the mandatory bid

Given this criticism and the well-recognised need for the protection of shareholders through a mechanism employing equal opportunity, it is clear that alternative to the mandatory bid or a modification of the current obligation should be explored.

It may be argued that the tests applied in the United States could replace the provisions currently employed to protect minority shareholders.[24] The 'proper business purpose' test and its attendant tests could be introduced to replace the mandatory bid. Should a transaction be contested by any of the shareholders of either of the parties to the transaction, the Securities Regulation Panel (or a court) would then be required to inquire firstly into whether or not a transaction was concluded for a proper business purpose. A next stage would encompass an inquiry of whether or not the majority shareholders breached any aspect of their fiduciary duty to the company – a duty non-existent in South African law. Finally, the competent court or authority would have to inquire into the fairness of the transaction as a whole – a test more familiar in the context of the compulsory acquisition procedure.

It is submitted that this procedure is not the ideal replacement for the mandatory bid. Firstly, the procedure removes protection that is automatically available to all shareholders and places the potenntially expensive barrier of an application to a court or authority between the aggrieved party and relief. Such an amendment would replace a protective measure with a remedy – or replace prevention with a cure.

Secondly, the test is founded on notions not indigenous to South African company law. In large, publicly held corporations, there is no fiduciary relationship between shareholders and the company.

8.3.2 Abolishing the mandatory bid

If it is not, as was submitted, desirable to replace the mandatory bid, it may well be considered necessary to merely discard the bid entirely. Should the obligation be abandoned, it is submitted that adequate alternative safeguards and/or remedies should be put in place.

It is submitted that such safeguards for minority shareholders are not currently in place. Existing remedies are not adequate in the arena of corporate control transactions. This is eminently evident from the Australian experience. Despite a significantly extended oppression

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influenced the decision thus taken by the majority shareholders, unfair dealing; and a conflict of interest between the majority and minority shareholders of the offeree company.

[24] See the discussion of these tests at 3.6 and 3.7.

remedy,[25] it was still, after long debate and extensive investigation, considered necessary to include the mandatory bid in the form encountered there, as a protective measure for minority shareholders.[26]

8.3.3 Reforming the mandatory bid

An alternative to replacing or abandoning the mandatory bid, is an extensive modification of the bid obligation. It is evident that it is possible, not only to modify the definitions of control and persons acting in concert along with the price requirement, but also to construct an exemption structure that accommodates uniquely South African considerations.

It would, for instance, be possible to build in partial price variables pursuant to the satisfaction of certain criteria, or to exempt certain offerors from compliance with the bid obligation. The urgent need for empowerment and redress is addressed in contemporary legislation on a variety of commercial issues and it may well be argued that it could also feature in corporate law.

8.4 Conclusion

The compulsory acquisition procedure offers a fair and balanced regime for shareholders – both those in the majority and those in the minority. A firm price equality guarantee, coupled with a flexible remedy in the right to approach court for an order that the acquisition either be blocked or conducted on different conditions.

The mandatory bid is more contentious and it is submitted that it be retained, albeit not in present form. It is a flexible and effective *ex ante* protection mechanism, based on a universally recognised equal opportunity principle, that is eminently capable of being adapted to the unique South African environment.

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[25] See 6.2.3 for a discussion on this remedy and its development in the Corporate Law Economic Reform Programme.

[26] See the discussion at 6.6 on the process pursuant to which the enactment of the mandatory bid was finally recommended.

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ANNEXURE A

FACULTY OF LAW

University of the Orange Free State

STYLE GUIDELINES

FOOTNOTES

Both source references and real footnotes must be contained in footnotes at the bottom of each page. The position of the footnotes references must be in the text in superscript in Arabic numbering and preferably always at the end of a sentence. Footnotes should be numbered in Arabic figures and should be presented in double spacing on separate pages if the authors printer cannot print them at the bottom of a page. As far as is practicable recognised abbreviations should be used. Source references should be done in the Harvard-style in the following manner:

1. Standard form: books and articles

1 Coetzee 1977:68-70.

2. Name in text

2 According to Van der Walt,[2] the correct ...

4. Two authors

3 Nel and Brink 1987:23.

5. More than two authors

4 Mouton ea 1986:51-55

6. More than one source

5 Brink 1978:33; Venter 1970:34.

7. More than one source per author

6 Brink 1978a:46; 1978b:57.

8. Court cases in South Africa after 1947

7 *Standard Bank v Neugarten* 1987 3 SA 695 W:703C-D.

Avoid any unnecessary mention of claimants and defendants such as *Standard Bank **of SA Ltd** v Neugarten* ... Note the colon after the reference in order to align the page reference system with that in other references.

9. Criminal cases

For criminal cases only the last name of the accused or abbreviation is used

8 *Tsutso* 1962 2 SA 666 SR:668 – 669
9 *K* 1956 3 SA 353 A:668

10. Court cases prior to 1947

For judgments delivered and reported prior to 1947 the traditional English abbreviations are used

9 *Baker v Baker* 1945 AD 708:710.

11. Second reference to court cases

At a second reference to court cases only the name of the relevant case and the pages are referred to – do not use *ibid* or *supra*

11 *Standard Bank v Neugarten*:705
12 *Tsutso*:670

12. Legislation

13 Close Corporations Act 69/1984.

If it is material to the discussion, reference may be made to amendments: Close Corporations Act 69/1984 (as amended by Act 21/1997). If reference is made to a particular section, it is done in the following manner:-

14 Close Corporations Act 69/1984: sec 55(3)(b).

At a second or further reference in the footnotes to an act, it is not necessary to state the number and year of the act:

15 Close Corporations Act:sec 56.

If it is evident from the text which act is referred to, it is sufficient to refer only to the relevant section:

16 Sec 58.

13 Proclamations and Government Notices

17 GN 162 *Government Gazette* 1974:103(4157.
18 Procl 147 *Government Gazette* 1976:131(2123).

The reference to the Government Gazette must be provided (vol 103 number 4157). In a second or further reference may be made in the following manner:

19 GN 162/1974.

14. Old writers and sources

Roman-Dutch authors and old sources are referred to in the bibliography (see below). In footnotes, only the following references are made:

20 Voet 37 6 1.
21 Van der Linden 1914: 1 8 1.
22 Van der Linden 1806: 1 9 10.
23 D 29 2 51.

If there is no more than one source by an author in the bibliography, there is no need to refer to the relevant year.

15. General: footnotes

Source references to authors must contain only the last name of the author without initial, except is there in more than one author in a given year with the same last name. Refer as far as is possible to pages and not to chapters. Source references should preferably be places at the end of a sentence or at the end of a quote. Avoid excessive references and authority or an excessive amount of sources in one reference. If a reference becomes too long, the text to which it relates should be reconsidered. Expressions such as 'my emphasis' should only be placed after the pages reference.

True footnotes, meaning footnotes containing additional information or explanatory notes to the main text should be kept to a minimum. In the use of the Harvard method important comments should preferably be contained in the main text. Inconsequential remarks should be considered for complete elimination. End-notes and end-remarks should be kept to a minimum.

Cross-references: Use English terms (see; see above; see below) and not the Latin terms such as Vide or Supra.

BIBLIOGRAPHY

A complete bibliography should be provided in the Harvard style with all relevant information on books and articles used in the compilation of the dissertation. References to court cases and legislation should not be included in the bibliography. List all bibliographical sources together without any categorisation, alphabetically, according to author (including institutions). The basic punctuation principle is that different units are referred to in the reference separated by full stops, with the minimum use of other forms of punctuation. Use the following format (note that no upper case or capital letters are used except to indicate real names).

1. Books

Bibliographical information on books should be presented in the following manner:

AUTHOR INITIALS
Year of publication. *Title of the book.* Edition (if applicable). Place of publication:Publisher.

For example:

COETZEE JS AND BRINK L
1978. *Writing research papers.* 2nd ed. Londen:Macmillan.

DRUCKER PF

1978. *The sociology of law.* New York:Basic Books.
1979. *Excellence in research.* New York:Basic Books.

2. Articles

Bibliographical information should be presented in the following manner:-

AUTHOR INITIALS

Year of publication. Title of the article. *Name of the journal in which it is published* volume (number):pages.

For example:

JOHNSON HJ

1977. On the effectiveness of legal policy. *American Law Journal* 36(2):1-24.

Note that the full name of the journal should be supplied and that upper case/capital letters are used in the name.

3. Contributions in compilation works

Contributions that form part of a collection of contribution must be listed separately with a reference to the collective work as such. Refer to the editor/editors as ed/eds.

SNYMAN AL

1977. The role of human rights in political reform. Van Rensburg 1986:1-34.

VAN RENSBURG CD (ed)

1986. *Human Rights in South Africa.* 2nd ed. Pretoria:HAUM.

4. Dissertations and papers

JAMES AP

1970. *Psychology and law.* Unpublished PhD dissertation. Pretoria:University of Pretoria.

BRINK JL

1986. *The role of human rights in political reform in South Africa.* Unpublished paper. Pretoria:Congress of the Juridical Association of South Africa.

5. Government publications

REPUBLIC OF SOUTH AFRICA

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6. Old writers and classical sources

CUJACIUS J
1758. *Opera omnia.* 10 vol. Napels.

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1806. *Regtsgeleerd practicaal en koopmans handboek.* Allart:Amsterdam.

VOET J
1698-1704. *Commentarius ad Pandectas.* Vol 1. De Hondt:Den Haag.

When referring to the old sources roman numerals may be provided if the author is unsure. If the publisher is unknown, this may be omitted and only the place of publication provided.

GENERAL REMARKS

Italics should not be used excessively. If used at all it should indicated emphasis. Latin terms such as *per se* may be printed in italics. Words and quotes in a language differing from that in which the dissertation is written should be indicated in inverted commas.

Statistics and other tables should be accompanied by short explanatory headings. The amount of tables should be kept to a minimum.