LEGAL ASPECTS OF THE REGULATION OF MERGERS AND ACQUISITIONS

by

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SUMMARY

One of the objectives of the Securities Regulation Code on Takeovers and Mergers ("the Code") was to achieve neutrality of treatment of minority shareholders in takeover situations irrespective of the method employed to effect the takeover. This objective has not yet been achieved despite the inclusion of Rule 29 in the Code. Different levels of minority protection apply depending on the method used to effect a takeover. Asset takeovers are also excluded from the ambit of the Code. It is suggested that capital reductions and security conversions be prohibited to effect a takeover unless the Code is applicable to the transaction. The scheme of arrangement procedure, with certain suggested amendments, should be retained as a takeover method. It is further suggested that section 228 of the Companies Act be amended to ensure greater minority shareholder protection but that asset takeovers not be included within the ambit of the Code at this stage.

KEY TERMS

Securities Regulation Code; Takeovers; Scheme of arrangement; Reduction of capital; Securities Conversion; Asset takeovers; Section 228 of the Companies Act, 1973; Mergers and acquisitions; Compensating advantage; Offeror and offeree company; Redeemable preference shares method; Standing Advisory Committee on Company Law.

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1. INTRODUCTION

The introduction of the Securities Regulation Code on Takeovers and Mergers ("the Code") [1] has had a profound impact on the South African law relating to the acquisition of securities. The stated objective of the Code, as laid down and applied by the Securities Relation Panel ("the Panel"), is to operate principally to ensure fair and equal treatment of all holders of relevant securities in relation to "affected transactions". The concept of "affected transactions" will be dealt with in due course, but, generally speaking, it relates to takeovers and mergers which fall within the definition of an "affected transaction". [2]

Due to the history of securities legislation in South Africa, it was a further objective of the Code to bring about neutrality of treatment irrespective of the vehicle chosen to effect a takeover. During the course of this dissertation the success of the Code and Panel in achieving this objective of neutrality of treatment will be evaluated. More specifically, the question is asked whether the Code is applicable to a takeover irrespective of the method employed to effect such a takeover. The various methods to effect a takeover will be analysed with a view to establishing whether the same level of shareholder protection is afforded in all instances.

The regulation of takeovers in South Africa is discussed and the exclusion of asset takeovers from the ambit of the Code and Panel is also considered. In conclusion a suggested solution is proposed, taking into account the current level of development of the South African law relating to the acquisition of securities.

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[1] Introduced on 18 January 1991 and promulgated in terms of the Companies Act 61 of 1973
[2] In section 440A (1) of the Companies Act 61 of 1973

2. TAKEOVERS

2.1 Definition

Weinberg and Blank [3] define a "takeover" as "a transaction or series of transactions whereby a person (individual, group of individuals or company) acquires control over the assets of a company, either directly by becoming the owner of those assets or indirectly by obtaining control of the management of the company". They distinguish a "takeover" from a "merger" which they describe as "a marriage between two companies, usually of roughly equal size, although it is quite common to use the word merger to include takeovers as well". [4]

A "takeover" is more narrowly defined in LAWSA [5] as "the acquisition of the control of a company..... by a person or company, usually accomplished by the acquisition or cancellation or redemption or issue (or by some combination of these) of a sufficient number of shares in the company to establish that control". It is, however, stated that the term "takeover" also refers to "the acquisition of control of the board of the company by obtaining sufficient proxies from the company's shareholders" and also to "the sale by a company of its business or all its assets". [6]

The fundamental purpose of a takeover is therefore the acquisition of control over the net assets of a company.

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[3] L Rabinowitz *et al Weinberg and Blank on Take-overs and Mergers* 5th Edition (1989) 1001
[4] In section 440A (1) of the Companies Act 61 of 1973
[5] Par 252
[6] W A Joubert (General Editor) *The Law of South Africa* First Reissue Volume 4 Part 1 (1995) Companies by M S Blackman par 252 footnote 2

For ease of reference the terms "offeror" and "offeree company" will be used throughout this dissertation. The "offeror" relates to the party effecting a takeover and "offeree company" relates to the company which is the subject of the takeover. Although more limited definitions are awarded to these terms in the Securities Regulation Code on Takeovers and Mergers, these terms will be used in this dissertation in a wider sense unless otherwise stated.

2.2 Reasons for takeovers

Many reasons can be identified why a company or person ("the offeror") might wish to acquire control over another company ("the offeree company"). Weinberg and Blank [7] distinguish between six main classes of motives why a company may wish to acquire control of an offeree company:

(i) The offeror can acquire the assets or shares of the offeree company at less than the value which the offeror places upon them, i.e. acquiring the assets at a discount. [8]

(ii) The offeror can, by taking over the offeree company, acquire the right to its profits at a lower multiple than the market places on the offeror's own profits, i.e. acquiring earnings at a discount. [9]

(iii) There is a trade advantage or element of synergy in bringing the two companies under single control, which is believed will result in the combined enterprise producing greater or more certain earnings than the sum of earnings of the two companies. [10]

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7 L Rabinowitz *et al Weinberg and Blank on Take-overs and Mergers* 5th Edition (1989) 1025
8 L Rabinowitz *et al Weinberg and Blank on Take-overs and Mergers* 5th Edition (1989) 1025
9 L Rabinowitz *et al Weinberg and Blank on Take-overs and Mergers* 5th Edition (1989) 1025
10 L Rabinowitz *et al Weinberg and Blank on Take-overs and Mergers* 5th Edition (1989) 1025

(iv) The takeover represents an attractive way for the offeror to enter a new market on a substantial scale. [11]

(v) The offeror has particular reasons for increasing its capital including the acquisition of a company with a large proportion of liquid assets or easily realisable assets instead of making a rights issue, and the acquisition of a company with high asset backing by a company whose market capitalisation includes a large element of goodwill. [12]

(vi) The takeover is the result of the motives of management of one or the other of the companies, either because of the aggressive desire to build up an empire or for personal remuneration or the defensive desire to make the company bid-proof. [13]

To this list may be added the acquisition of technology. Rather than spending vast amounts of money on the development of specific technology it might be acquired by taking over another company which has already developed such technology. [14] Another possible reason could be the acquisition of strategic personnel as in the case of the acquisition of Finansbank by the Nedbank group. [15]

Usually elements of different motives will be intermingled in the decision to take over a company.

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[11] L Rabinowitz *et al Weinberg and Blank on Take-overs and Mergers* 5th Edition (1989) 1026
[12] L Rabinowitz *et al Weinberg and Blank on Take-overs and Mergers* 5th Edition (1989) 1026
[13] L Rabinowitz *et al Weinberg and Blank on Take-overs and Mergers* 5th Edition (1989) 1026
[14] J Coetzee "Hoe om 'n maatskappy te koop" (28 Junie 1991) *Finansies en Tegniek* 34
[15] J Coetzee "Hoe om 'n maatskappy te koop" (28 Junie 1991) *Finansies en Tegniek* 34

2.3 Techniques of achieving a takeover

2.3.1 *Introduction*

There are a number of methods by which a takeover can be effected. [16] The various methods differ in the extent of support required from the directors or shareholders of the two companies concerned and in the extent to which the Court may have a role to play. The method chosen in any particular case will depend on a number of factors. A discussion of these factors, however, does not fall within the ambit of this dissertation. [17]

During the course of this dissertation not all techniques of achieving a takeover will be analysed. The discussion will be limited to those techniques which are most frequently utilised in practice. In this regard specific emphasis will be placed on the scheme of arrangement, reduction of capital, conversion of securities and sale of assets methods. Particular reference will also be made to a takeover by means of a purchase or exchange of shares which is the most obvious means of effecting a takeover. Other possible methods will only be mentioned in passing. Section 2 will deal with the typical operation of these methods in practice, the impact of the Companies Act [18] on these methods and the approach adopted by our Courts in dealing with the various methods of effecting a takeover. Reference will also be made to the views of legal writers.

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[16] See e.g. L Rabinowitz *et al Weinberg and Blank on Take-overs and Mergers* 5th Edition (1989) 2001 and MM Katz "Legal aspects of the regulation of take-overs" (1979) *Modern Business Law* 53

[17] For a discussion of the various factors influencing the decision on which method to utilise, see L Rabinowitz *et al Weinberg and Blank on Take-overs and Mergers* 5th Edition (1989) 2001

[18] Companies Act 61 of 1973

In section 3 the impact of the Securities Regulation Code on Takeovers and Mergers on these techniques of achieving a takeover will be analysed in so far as they constitute "affected transactions".

Section 3.1 will specifically deal with the historical development of the regulation of takeovers in South Africa. The position prior to 1991, as regulated by the Companies Acts of 1926 and 1973, [19] will be discussed. The regulation, or lack thereof, of the various techniques of effecting a takeover prior to 1991 will also be discussed.

2.3.2 *Scheme of arrangement procedure*

2.3.2.1 *The use of section 311* [20]

From time to time companies are required to negotiate with persons such as creditors and shareholders, who have claims against the company, in order to amend such claims in the interest of all parties. [21] However, these claims are often held by large groups of persons, making it impossible for the company to negotiate with every individual person. [22] There is therefore a need for a procedure in terms whereof the company may negotiate collectively with such a group. [23] A mechanism is also necessary which enables the company to bind all members of the specific group to an agreement which has been reached with the majority of that group. [24]

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[19] Companies Act 46 of 1926 and Companies Act 61 of 1973
[20] Of Companies Act 61 of 1973
[21] H S Cilliers *et al Korporatiewe Reg* 2nd Edition (1992) 447
[22] H S Cilliers *et al Korporatiewe Reg* 2nd Edition (1992) 447
[23] H S Cilliers *et al Korporatiewe Reg* 2nd Edition (1992) 447
[24] H S Cilliers *et al Korporatiewe Reg* 2nd Edition (1992) 447

Although such a procedure or mechanism is often created contractually, e.g. in the constitution of a company, it could happen that the relevant rights which the parties wish to amend may not be altered in terms of the specific contract or the parties which the company wishes to negotiate with are not parties to such a contract and therefore not bound by the contract. [25]

Accordingly, the Companies Act [26] has created such procedures and mechanisms to ensure that an enforceable agreement can be reached with shareholders and/or creditors. [27] Such a procedure and mechanism have been created in section 311 of the Companies Act. [28] This section makes it possible to reach a compromise or arrangement between a company and its members and/or creditors.

Where a compromise or arrangement is proposed between a company and its creditors or any class of them or between a company and its members or any class of them, section 311 (1) [29] provides for an application to Court upon which the Court may order a meeting of creditors or a class of creditors or of the members of the Company or class of members, as the case may be, in such a manner as the Court may direct.

Section 311 (2) [30] further provides that the proposed compromise or arrangement must be approved by a 75% majority and sanctioned by the Court for it to become binding. A second application to Court, for sanctioning, is therefore required.

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[25] H S Cilliers *et al Korporatiewe Reg* 2nd Edition (1992) 448
[26] Companies Act 61 of 1973
[27] H S Cilliers *et al Korporatiewe Reg* 2nd Edition (1992) 448
[28] Companies Act 61 of 1973
[29] Of Companies Act 61 of 1973
[30] Of Companies Act 61 of 1973

Although this was clearly not the original purpose of section 311, [31] the scheme of arrangement became a popular vehicle to achieve a takeover of a company. The original motive for using this procedure to effect a takeover was to avoid the payment of stamp duty on the transfer of shares. [32] By virtue of section 23, read with Item 15 (4) of Schedule 1 of the Stamp Duties Act, [33] this is no longer the case and stamp duty is payable in the case of a scheme of arrangement. [34] Although the stamp duty advantage fell away, the scheme of arrangement procedure to effect a takeover remained popular due to its less onerous requirements if compared to the requirements of the substantive takeover provisions [35] in the Companies Act. [36] The effect of the Securities Regulation Code on Takeovers and Mergers on the scheme of arrangement procedure will be dealt with in section 3 of this dissertation.

An *obiter* remark by Plowman J in the English case of *Re National Bank Ltd* [37] marked the commencement of the use of the scheme of arrangement procedure to effect a takeover. [38] In this case the learned Judge held [39] that the relevant scheme of arrangement in that case only had to comply with the English scheme of arrangement requirements and not with their section 209 [40] which required a 90% majority to approve the scheme. Although the scheme of arrangement under discussion was not a true takeover bid, the implication of the judgement was that such a takeover bid could be effected by means of a scheme of arrangement to the exclusion of the substantive takeover provisions in their Act. [41]

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[31] Of Companies Act 61 of 1973
[32] M M Katz "Legal aspects of the regulation of take-overs" (1979) *Modern Business Law* 55
[33] Companies Act 77 of 1968
[34] H S Cilliers *et al Korporatiewe Reg* 2nd Edition (1992) 463
[35] The now repealed sections 314 - 321 of the Companies Act 61 of 1973
[36] Companies Act 61 of 1973
[37] [1966] 1 All ER 1006 at 1012 - 1013
[38] S W L de Villiers "Take-overs under section 311 to 321 of the Companies Act 1973" (1973) *SALJ* 351
[39] At 1012
[40] Of the Companies Act, 1948
[41] This was the interpretation of the *Re National Bank Ltd* Judgement in *Ex Parte Federale Nywerhede Beperk* 1975 (1) SA 826 (W) at 830

Plowman J continued and stated that the fact that the Court needs to determine the fairness of the scheme before sanctioning such a scheme offered sufficient protection to shareholders. [42] Even though a smaller majority (75% as opposed to 90%) is required to approve a scheme of arrangement, further protection is provided by the Court's supervision.

In *Ex Parte Federale Nywerhede Bpk* [43] Coetzee J endorsed the view of Plowman J and held that there was no reason why a takeover could not be effected by means of a scheme of arrangement as long as it is a compromise or arrangement between the company and its members and/or creditors. [44] This, he held, [45] was true in the case of both a scheme of arrangement under the old section 103 of the Companies Act of 1926 [46] and in terms of section 311 of the new Companies Act of 1973. [47] Although Coetzee J found it odd that the old sections 314 to 321 [48] could be circumvented with ease by utilising section 311, [49] he was of the opinion that should there be a need to remedy this position this should be done by the Legislature. [50]

De Villiers [51] expressed criticism against the fact that a takeover could be effected by means of section 311 of the Companies Act [52] to the exclusion of the substantive takeover provisions contained in section 314 to 321 of the Companies Act. [53] He was critical of the fact that two procedures with "vastly different safeguards and

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[42] At 1013
[43] 1975 (1) SA 826 (W)
[44] At 830 - 831
[45] At 831 - 832
[46] Companies Act 46 of 1926
[47] Companies Act 61 of 1973
[48] Of Companies Act 61 of 1973
[49] Of CompaniesAct 61 of 1973
[50] At 832
[51] S W L de Villiers "Take-overs under section 311 to 321 of the Companies Act 1973" (1973) *SALJ* 350
[52] Companies Act 61 of 1973
[53] Companies Act 61 of 1973

requirements, imposing vastly different responsibilities on persons responsible for supplying information to offeree shareholders" were available to offerors. [54] Differently stated, there was no neutrality of treatment between the various methods of effecting a takeover.

Despite criticism like that of De Villiers and others, the legal position was again confirmed in *Ex Parte SATBEL (Pty) Ltd (Meyer N O intervening).* [55] Gordon AJ held [56] that there was no bar to proceeding in terms of section 311 [57] if the requirements of that section are met even if the scheme amounts to a takeover.

In *Ex Parte Mielie-Kip Ltd* [58] Flemming DJP did not disagree with the position that section 311 [59] could be used to effect a takeover. However, he confirmed that the Court's discretion to confirm such a scheme of arrangement should not be exercised in favour of an applicant if the proposed arrangement "can conveniently and effectively be carried out by the company and its creditors without involving the provisions of the section". [60] The fact that the substantive provisions of section 314 [61] were more "cumbersome and time-consuming" than the scheme of arrangement procedure was not sufficient and the application was denied. [62]

The conclusion that can be reached from the above is that the scheme of arrangement procedure [63] could be used to effect a takeover despite the criticism against this position. However, all the requirements of section 311 [64] must have

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[54] S W L de Villiers "Take-overs under section 311 to 321 of the Companies Act 1973" (1973) *SALJ* 366
[55] 1987 (3) SA 440 (W) at 446
[56] At 446
[57] Of Companies Act 61 of 1973
[58] 1991 (3) SA 449 (W) at 455
[59] Of Companies Act 61 of 1973
[60] At 455
[61] Of Companies Act 61 of 1973
[62] At 455
[63] In terms of section 311 of Act 61 of 1973
[64] Of Companies Act 61 of 1973

been met before the Court would exercise its discretion to approve the scheme. The fact that the scheme of arrangement procedure provided a more expeditious method of effecting a takeover was not sufficient ground for allowing such an application. The desirability of the use of this procedure under the current dispensation will be dealt with in section 5 of this dissertation.

2.3.2.2 ***Structuring a scheme of arrangement to effect a takeover***

In practice, when the scheme of arrangement procedure is utilised to effect a takeover, the takeover is structured in the following manner :

The takeover is cast in the form of a reorganisation of the authorised and issued, or just the issued, share capital of the offeree company. [65] In terms of this reorganisation the offeror is in effect substituted for the existing shareholders of the offeree company. [66] The reorganisation is effected by means of a scheme of arrangement between the offeree company and its shareholders [67] whose shares will be affected by the scheme. [68] A scheme of arrangement is submitted to the shareholders of the offeree company for approval in terms whereof the issued share capital not held by or on behalf of the offeror is cancelled by means of a capital reduction. [69] The proceeds of the cancellation, which is equal to the nominal value of the cancelled shares, is then placed to the credit of a special capital reserve account created for that purpose. [70] Simultaneously with the reduction of capital the share capital of the offeree company is again increased, usually to its full former

[65] S W L de Villiers "Take-overs under section 311 to 321 of the Companies Act 1973" (1973)*SALJ* 351
[66] S W L de Villiers "Take-overs under section 311 to 321 of the Companies Act 1973" (1973) *SALJ* 351
[67] In terms of section 311 of Companies Act 61 of 1973
[68] S W L de Villiers "Take-overs under section 311 to 321 of the Companies Act 1973" (1973) *SALJ* 351
[69] S W L de Villiers "Take-overs under section 311 to 321 of the Companies Act 1973" (1973) *SALJ* 351
[70] S W L de Villiers "Take-overs under section 311 to 321 of the Companies Act 1973" (1973) *SALJ* 352

value, by the creation of new shares which are, in turn, allotted to the offeror as fully paid-up by applying the credit amount on the special capital reserve. [71]

In consideration for the above allotment of new shares to it, the offeror then allots an agreed number of its shares or pays the agreed consideration to the former shareholders of the offeree company. [72] Through the above process the offeror becomes the holder of all the issued shares, or all the issued shares of a certain class in the offeree company.

A typical illustration of the above procedure can be seen in *Ex Parte Federale Nywerhede Beperk.* [73] *In casu* the scheme of arrangement procedure was used in conjunction with a reduction of capital as described above. The takeover took the form of a cancellation of the company's issued shares held by "outside shareholders" (that is, the shares which did not belong to the applicant's holding company). In return, shares in the holding company were to be issued to such outside shareholders. [74] The cancellation of the shares was effected by way of a reduction of capital. [75] The offeror, who in effect was substituted for the holders of the cancelled shares, had to issue the shares to the shareholders as consideration for the cancellation. [76]

The holding company of the applicant, which was to issue the new shares in consideration, was not a party to the contract. To overcome this problem, the Court ordered that a suitable contract between the applicant and the holding company,

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[71] S W L de Villiers "Take-overs under section 311 to 321 of the Companies Act 1973" (1973) *SALJ* 352
[72] S W L de Villiers "Take-overs under section 311 to 321 of the Companies Act 1973" (1973) *SALJ* 352
[73] 1975 (1) SA 826 (W)
[74] At 828
[75] At 828
[76] At 828 - 829

providing for the issuing of the relevant shares, had to be submitted to the Registrar before the court order could be uplifted. [77] This order was also given to overcome the perceived problem that, should such an order not be given, the scheme might constitute a confiscation without any "compensating advantage" given to the shareholders who were expropriated. [78]

A reduction of capital must be effected in terms of the provisions of the Companies Act that regulate such reductions. [79] Utilising the scheme of arrangement procedure, in conjunction with a reduction of capital, does not exempt the offeror of also complying with the relevant capital reduction provisions in the Companies Act. [80] In so far as a reduction of capital constitutes a component of the scheme of arrangement, it cannot be achieved solely by means of the scheme of arrangement. [81] This was confirmed in clear terms by the Court in *Ex Parte NBSA Centre Ltd* [82] where it was said that :

> "Sections 83 - 88 govern reduction of capital in clear peremptory terms and there is no way that this kind of reduction can be achieved in any other shape or form, be it in purported scheme of arrangement fashion or any other... There is not the slightest warrant anywhere in the Act for even a faint argument that a company's capital can legally be reduced in any other way than by the applicable reduction procedure".

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[77] At 835
[78] See page 835 of the judgement
[79] Sections 83 - 90 of the Companies Act 61 of 1973
[80] Companies Act 61 of 1973
[81] *Ex Parte NBSA Centre Ltd* 1987 (2) SA 783 (T)
[82] 1987 (2) SA 783 (T) at 794

The scheme of arrangement procedure is not only used where the offeree company is in financial difficulty. However, utilising the scheme of arrangement procedure to effect a takeover represents the most expeditious and economic means of acquiring a company in financial difficulties and, at the same time, ridding the company of its existing creditors. [83] The utilisation of the procedure laid down by section 311 has definite advantages. The biggest advantage of section 311 is that it allows an offeror to take over a company in financial difficulty at a price just sufficient to exceed the dividend to creditors which would have been paid in case of a liquidation. [84] The company is thus taken over without the burden of creditors, often with a large assessed loss with its accompanying tax advantages. [85]

When compared to some other methods of achieving a takeover, the scheme of arrangement procedure also offers substantial protection to minority shareholders during a takeover. [86] The minority protection offered by this procedure includes :

- A prescribed majority of the affected shareholders must approve the scheme. [87]
- The Court is a participant to the scheme by virtue of the fact that it needs to sanction the proposed scheme. [88]
- The Court appoints a chairman who supervises the necessary meeting. [89]
- The explanatory statement in terms of section 312 [90] which provides for compulsory disclosure. [91]

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[83] Richard Jooste "Schemes of Arrangement - a New Development" (February 1989) *Income Tax Reporter 7*
[84] Richard Jooste "Schemes of Arrangement - An Answer to the Problem?" (March 1989) *Businessman's Law 133*
[85] Richard Jooste "Schemes of Arrangement - An Answer to the Problem?" (March 1989) *Businessman's Law 133*
[86] M M Katz "Legal Aspects of the Regulation of Take-overs" (1979) *Modern Business Law* 55
[87] M M Katz "Legal Aspects of the Regulation of Take-overs" (1979) *Modern Business Law* 55
[88] M M Katz "Legal Aspects of the Regulation of Take-overs" (1979) *Modern Business Law* 55
[89] M M Katz "Legal Aspects of the Regulation of Take-overs" (1979) *Modern Business Law* 55
[90] Of Companies Act 61 of 1973
[91] M M Katz "Legal Aspects of the Regulation of Take-overs" (1979) *Modern Business Law* 55

A further benefit of the scheme of arrangement procedure highlighted by Katz [92] is the possibility of a physical merger of assets and liabilities of the offeror and offeree companies in terms of section 313 of the Companies Act. [93]

2.3.2.3 ***Judicial approach to "arrangements"***

Section 311 and 312 [94] provide for numerous requirements which need to be complied with in order to achieve a successful scheme of arrangement. Most of these requirements are clear and have provided few problems of interpretation to parties to a scheme of arrangement. Consequently, this dissertation will not attempt to deal with all requirements or to be an exhaustive guide on the requirements for a successful scheme of arrangement. The discussion in this paragraph will be limited to some of the controversial aspects of section 311 [95] which have resulted in conflicting judgements by our Courts in recent years.

Section 311 [96] requires a compromise or arrangement between a company and its creditors or any class of them or between a company and its members or any class of them. In interpreting this requirement two issues have emerged as a primary source of legal uncertainty in South Africa. These are the question as to what constitutes an acceptable "compensating advantage" when minority shareholders are expropriated and, secondly, the requirement that the offeree company must be a true participant to the scheme of arrangement.

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[92] M M Katz "Legal Aspects of the Regulation of Take-overs" (1979) *Modern Business Law* 55
[93] Companies Act 61 of 1973
[94] Of Companies Act 61 of 1973
[95] Of Companies Act 61 of 1973
[96] Of Companies Act 61 of 1973

Compensating advantage

Confirmation of a scheme of arrangement to effect a takeover usually has the effect that at least some of the members of the offeree company are expropriated. This is a necessary consequence of the section 311 [97] mechanism in terms whereof the minority is bound by the decision of the majority. As to how such expropriated members should be compensated there have been divergent views.

One of the first cases to address this issue was *Re NFU Development Trust.* [98] In this case Brightman J held [99] that :

> "Confiscation is not my idea of an arrangement. A member whose rights are expropriated without any compensating advantage is not, in my view, having his rights re-arranged in any legitimate sense of that expression."

In 1975 Coetzee J cited the above *dictum* of Brightman J with approval in *Ex Parte Federale Nywerhede Bpk.* [100] The learned Judge added [101] that this "compensating advantage" refers to an enforceable compensation. The question as to what would constitute an acceptable "compensating advantage" has provided some difficulty to our Courts during subsequent years.

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[97] Of Companies Act 61 of 1973
[98] [1973] 1 All ER 135 (Ch)
[99] At 140
[100] 1975 (1) SA 826 (W) at 834
[101] At 834

In *Ex Parte SATBEL (Edms) Bpk : in re Meyer en andere v SATBEL (Edms) Bpk* [102] the Court was asked to pronounce upon a proposed scheme of arrangement in terms whereof one of the majority shareholders attempted to take over the shares of the minority shareholders for a monetary consideration of R6 per share. Coetzee J held [103] that to qualify as an arrangement there must be at least a re-arranging of shareholders' rights. [104] An exchange of shares for membership in a controlling company would qualify as such a re-arranging of rights. However, should the members' rights be extinguished in exchange for a monetary compensation, ex-propriation takes place and his rights are not "re-arranged in any legitimate sense of that expression". [105]

The Court continued [106] by stating that the members' rights must continue to exist, *albeit* in a different guise, but should not be extinguished. *In casu* the Court therefore held that the proposed scheme of arrangement entailed the destruction of interests and accordingly refused to sanction the proposed scheme of arrangement. [107] Coetzee J was therefore emphatic in his rejection of a monetary consideration as an acceptable "compensating advantage" for expropriated members.

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[102] 1984 (4) SA 347 (W)
[103] At 359
[104] At 359
[105] At 359
[106] At 359
[107] At 359

The approach of Coetzee J was followed in the case of *Ex Parte Natal Coal Exploration Co Ltd* [108] where it was held [109] that expropriation of rights of a shareholder, compensated by a sum of money, lies outside the ambit of an "arrangement" in terms of section 311. [110] A shareholder must receive a "compensating advantage" which consists of or includes other rights. The facts and circumstances of each case will determine what other rights will be adequate for purposes of section 311. [111]

The Court therefore followed the ratio of the *SATBEL* case [112] and dismissed the application. Stegmann J specifically held [113] that "the practical implications of the conclusions to which I am driven in this matter by the decision in the *SATBEL* case do not appear to me to be disturbing or to depart in any way from what may be taken to have been the intention of the Legislature." Stegmann J was therefore in agreement with Coetzee J that, even with a fair assessment of the compensation, a monetary consideration was not a fair "compensating advantage".

The approach followed in the *SATBEL* [114] and *Natal Coal Exploration* [115] cases was rejected by Van den Heever J in *Ex Parte Suiderland Development Corporation Ex Parte Kaap-Kunene Beleggings Bpk.* [116] Van den Heever J stated that: [117]

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[108] 1985 (4) SA 279 (W)
[109] At 284
[110] Of Companies Act 61 of 1973
[111] Of Companies Act 61 of 1973
[112] 1984 (4) SA 347 (W)
[113] At 285
[114] 1984 (4) SA 347 (W)
[115] 1985 (4) SA 279 (W)
[116] 1986 (2) SA 442 (C)
[117] At 445

"Why the "compensating advantage" should have to take the form of retention of rights as members of the company, escapes me. There is nothing in any dictionary to compel such an interpretation".

The learned Judge continued [118] and stated that if the Legislature wished to limit the ambit of an "arrangement" in terms of section 311 [119] it would have done so by definition in the Act. Accordingly, there was no reason to limit the definition of an "arrangement" as contended by Stegmann J.

In *Ex Parte NBSA Centre Ltd* [120] Coetzee DJP had a further opportunity to consider the correctness of his approach in the *SATBEL* [121] case. This time the Judge held [122] that "after further reflection" he was willing to concede that he was wrong in his interpretation of the ambit of "arrangement". In so far as he had decided that a cancellation of shares in return for a monetary consideration can not fall within the ambit of section 311, [123] this was a decision resting "too heavily on nuance and feel". Coetzee DJP therefore held [124] that to the extent that his approach was followed and developed by Stegmann J as the *ratio decidendi* of the *Natal Coal Exploration* case, [125] this was "equally wrong".

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[118] At 445 - 446
[119] Of Companies Act 61 of 1973
[120] 1987 (2) SA 783 (T)
[121] 1984 (4) SA 347 (W)
[122] At 792
[123] Of Companies Act 61 of 1973
[124] At 792
[125] 1985 (4) SA 279 (W)

In the *NBSA* case [126] Goldstone J, in his judgement, also confirmed that "expropriation for fair compensation is indeed a case of give and take". He accepted that a cash consideration did not exclude a scheme from the ambit of section 311.[127] Although Coetzee DJP shared this view in his judgement, it was not the basis for his decision and can therefore not be regarded as *ratio decidendi*. [128]

In *Ex Parte Mielie-Kip Ltd* [129] Flemming DJP accepted that a scheme of arrangement in terms of section 311 [130] may provide for the termination of the relationship between the shareholder and the company with or without substitution of a new relationship between the member and the company. Although this was again an *obiter* remark it is clear that the submission that a cash consideration is not an adequate "compensating advantage" will find very little support in our Courts. The question no longer seems to be whether a cash consideration is acceptable compensation for an expropriation, but rather whether there is a scheme of arrangement between the offeree company and the member. The proposed scheme must affect "the existence, scope or content of the relationship between the company and the member". [131]

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[126] 1987 (2) SA 783 (T) at 812
[127] Of Companies Act 61 of 1973
[128] Gordon AJ did not decide this matter in his concurring judgement. See page 813 of the judgement
[129] 1991 (3) SA 449 (W) at 453
[130] Of Companies Act 61 of 1973
[131] *Ex Parte Mielie-Kip Ltd* 1991 (3) SA 449 (W) at 453

Participation of offeree company

The scheme of arrangement procedure is only available if the scheme of arrangement is one between the offeree company and its members and/or creditors. [132] In other words, the company must be a true participant to the scheme. [133] Section 311 (1) [134] refers to a compromise or arrangement "proposed between a company and its creditors ..." or between "a company and its members...". The common denominator for section 311 to be applicable, is the participation of the company itself. It follows that the company, by way of a board resolution or by a majority of members in general meeting, must consent to the proposed arrangement. If the company's consent is not obtained the Court has no jurisdiction under section 311 [135] to sanction an arrangement. [136]

The question whether the offeree company was a true participant to the scheme of arrangement arose in *Ex Parte Federale Nywerhede Bpk.* [137] The mechanics of the scheme were explained earlier in paragraph 2.3.2.2 but the relevant portion, for present purposes, was that the shares held by members other than the offeror were to be cancelled and that these expropriated members were to receive consideration for this cancellation in due course from the offeror. [138] The question arose whether in light of these facts the offeree company was a true participant to the scheme. The Court answered this question in the affirmative, holding that it was a reasonable implication of the scheme that there was an obligation on the offeree company to

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[132] Section 311 (1) of the Companies Act 61 of 1973.
[133] *Ex Parte Federale Nywerhede Bpk* 1975 (1) SA 826 (W) at 830 - 831
[134] Of Companies Act 61 of 1973.
[135] Of Companies Act 61 of 1973
[136] Richard Jooste "Schemes of Arrangement - An Answer to the Problem?" (March 1989) *Businessman's Law 133*
[137] 1975 (1) SA 826 (W)
[138] At 834

ensure that the expropriated members receive their consideration in due course from the offeror. [139] Although the Court accepted the above obligation of the offeree company as implicit to the proposed scheme, this obligation of the offeree company was not clear from the proposed scheme. As the Court insisted on an enforceable obligation, the learned Judge ordered the offeree company to file an acceptable contract, in terms whereof the offeror committed itself towards the members, with the Registrar before the court order could be uplifted. [140] *In casu* the Court thus gave a very wide interpretation to the requirement that the offeree company must be a true participant to the scheme.

In *Ex Parte SATBEL (Edms) Bpk* : in *Re Meyer en andere v SATBEL (Edms) Bpk* [141] the Court had a further opportunity to consider the required level of participation by the offeree company. During the course of proceedings [142] the Court was referred to the English case of *Re Savoy Hotel Ltd* [143] where the Chancery Division sanctioned a proposed scheme of arrangement in terms whereof the affected shareholders had the option of receiving shares in the offeror or receiving a monetary compensation for relinquishing their shares in the company. The only role of the offeree company was that it was obliged, in terms of the proposed scheme, to effect the transfer of the relevant shares. Coetzee J [144] rejected the view that the above was sufficient to qualify as an arrangement and held that the mere registration by the company of a transfer of shares is not sufficient to qualify as an "arrangement between the company and the member".

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[139] At 834
[140] At 834 - 835
[141] 1984 (4) SA 347 (W)
[142] At 359 - 360
[143] [1981] 3 All ER 646 (Ch)
[144] At 360

The obligations of the offeree company in the *SATBEL* case [145] were not dissimilar to the obligations of the offeree company in *Ex Parte Federale Nywerhede Bpk.* [146] Yet the Court came to a different conclusion on the question whether the offeree company was a true participant to the scheme. In the *SATBEL* case the Court followed a more restrictive interpretation of this requirement. An approach, it is submitted, which is to be preferred. Should an offeror wish to utilise the mechanism of a scheme of arrangement to effect a takeover, which did not represent the substantive takeover mechanism, it is submitted that such an offeror should fully comply with all requirements of section 311. [147] It is further submitted that there is no reason why a liberal approach to interpreting the scheme of arrangement requirements should be endorsed.

In *Ex Parte Mielie-Kip Ltd* [148] Flemming DJP considered the participation of the offeree company where the shareholders in the offeree company sold their shares to the offeror. The Court refused to sanction the scheme of arrangement, holding that the offeree company was not a true participant to the proposed scheme. [149]

The Court held that the purchase of shares is an arrangement between buyer and seller. "In no ordinary sense of the word is the sale an arrangement between the company and either the buyer or the seller". [150] Accordingly, such an arrangement will not fall within the ambit of section 311, [151] not being an arrangement between the company and its members. The Court [152] continued by stating that "involvement

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[145] 1984 (4) SA 347 (W)
[146] 1975 (1) SA 826 (W)
[147] Of Companies Act 61 of 1973
[148] 1991 (3) SA 449 (W)
[149] At 455 - 456
[150] At 451
[151] Of Companies Act 61 of 1973
[152] At 451

in the transaction [by the company] is also not caused thereby that the issuer of the securities must, as other members of the community, respect the transaction or has an obligation to record the ensuing transfer of the shares". *In casu* the Court exercised its discretion to refuse the application because the proposed arrangement could conveniently and effectively be carried out by the company and its members without invoking the provisions of the section. [153]

During the course of his judgement Flemming DJP identified possible subject-matters for an arrangement between a company and its members. [154] These included "the continued existence or not of issued or issuable shares; the consolidation or splitting of shares; the right of redemption, to dividends, in regard to voting, etc. attaching to shares". The fact that certain obligations were given to the "offeree company", *inter alia* that it would have "supervised and administered" the payment by the offeror to its members, was not sufficient to make the "offeree company" a participant to the scheme. [155] The sale of the shares in no way affected "the existence, scope or content of the relationship between the company and the member". [156] Only the identity of the member would have changed and not the quality of the relationship between the member and company. [157]

In *NAMEX (Edms) Bpk v Kommissaris van Binnelandse Inkomste* [158] the Appellate Division had the opportunity to consider a scheme of arrangement entered into between a company and its creditors. In his judgement, [159] Goldstone AJ considered the required role of the company to qualify as a true participant to a

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[153] At 455
[154] At 453
[155] At 451 and 453
[156] At 453
[157] At 453 - 454
[158] 1994 (2) SA 265 (A)
[159] At 294

section 311 [160] scheme of arrangement. He held [161] that section 311 [162] schemes had a major role in the commercial world and as such the Courts should not give a restrictive interpretation to the requirements of the section. However, if the offeree company has only a passive role it is not a compromise or scheme proposed "between a company and its creditors". [163]

On the other hand it was held not to be necessary that the company's active role should be significant. [164] *In casu* he held that the term in the proposed scheme obliging the offeree company to cancel a certain agreement previously entered into by the provisional liquidators was sufficient to render the company a true participant.

From this judgement it seems that the view of the Appellate Division is that a mere administrative role given to an offeree company in terms of a proposed scheme of arrangement is sufficient to bring the scheme within the ambit of section 311 of the Companies Act. [165] Although the remarks of Goldstone AJ were *obiter*, it is significant that his approach differed from that of Flemming DJP in *Ex Parte Mielie-Kip Ltd* [166] who favoured a more restrictive approach. [167]

According to *LAWSA* [168] "there seems to be no reason why the company and its members cannot enter into a scheme of arrangement in terms of which the members bind themselves to the company to transfer their shares to a third party, coupled with

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[160] Of Companies Act 61 of 1973
[161] At 294
[162] Of Companies Act 61 of 1973
[163] At 294
[164] At 294
[165] Companies Act 61 of 1973
[166] 1991 (3) SA 449 (W)
[167] See also MP Larkin "Company Law Legislation" (1987) *Annual Survey of South African Law* 256 at 267. Larkin also disagreed with an interpretation of section 311 of the Companies Act which insists upon an active role or involvement by the company as opposed to just insisting that the company agree to the compromise or arrangement. His approach is therefore in line with that of Goldstone AJ in the *Namex* case.
[168] Par 254

an undertaking, as a condition precedent, given by the third party to the company to deliver the proposed consideration to its members." This statement can not be endorsed unequivocally. The essence of the transaction remains that of a sale of shares by the members to an offeror. The mere adding of administrative duties to the company should not be sufficient to render the company a true participant to the scheme. Although there is some degree of conflict between the approaches adopted in *Ex Parte Federale Nywerhede Bpk* [169] and *Namex* [170] on the one hand, and that in *Ex Parte Mielie-Kip Ltd,* [171] it is submitted that the approach in *Mielie-Kip* is the preferred approach. The intention of section 311 [172] was never to cater for a simple sale of shares. The question that needs to be answered is whether the scheme of arrangement procedure should be used to effect a takeover at all. This question will be reverted to in section 5 of this dissertation.

In conclusion, Delport [173] endorses the view expressed in *Ex Parte NBSA Centre Limited* [174] that the scheme of arrangement procedure is to be used only where the normal mechanisms for reaching agreement between members on the one hand and the company on the other are not available due to the content of the particular scheme. He states that the confusion and uncertainties that prevail in the present system will only fade if this is done. This aspect will be reverted to in section 5.

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169 1975 (1) SA 826 (W)
170 1994 (2) SA 265 (A) (*Obiter* remarks of Goldstone AJ)
171 1991 (3) SA 449 (W)
172 Of Companies Act 61 of 1973
173 Piet Delport "Section 311 of The Companies Act and the Share Cases" (1994) *De Jure* 175
174 1987 (2) SA 783 (T).

2.3.3 *Reduction of capital method*

As was pointed out in the previous section, the scheme of arrangement procedure can be combined with the reduction of capital method to effect a takeover. It is, however, also possible to effect a takeover by means of the reduction of capital method without utilising the scheme of arrangement procedure. [175] In practice a typical example of this procedure is as follows :

(a) The offeror, wishing to obtain the total issued share capital of the offeree company, is either the holding company of the offeree company, has a number of shares in the offeree company or purchases a small number of shares in the offeree company. [176]

(b) After passing a special resolution the offeree company then approaches the Court, applying for an order in terms of section 84(1) [177] to confirm the reduction of its share capital by cancelling the shares of all shareholders apart from those shares held by the offeror. [178]

(c) A surplus arises from this cancellation of shares which is credited to a non-distributable reserve account in the books of the offeree company. [179]

(d) The offeror, which was not a party to the application to Court, now provides the holders of the cancelled shares with shares in the offeror company, or cash, or with a combination of these two in consideration for the cancellation of their shares. [180] This consideration is given as a *quid pro quo* for

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[175] In terms of section 84 of the Companies Act 61 of 1973
[176] M M Katz "Legal Aspects of the Regulation of Take-overs" (1979) *Modern Business Law* 56
[177] Of Companies Act 61 of 1973
[178] M M Katz "Legal Aspects of the Regulation of Take-overs" (1979) *Modern Business Law* 56
[179] M M Katz "Legal Aspects of the Regulation of Take-overs" (1979) *Modern Business Law* 56
[180] M M Katz "Legal Aspects of the Regulation of Take-overs" (1979) *Modern Business Law* 56

consenting to the reduction of capital and is given after registration of the relevant special resolution and the surrendering of the share certificates by these former members. [181]

Katz [182] raised compelling arguments in favour of the proposition that it is not legally competent to use the reduction of capital procedure to achieve a takeover bid. In support of his contention he presented two categories of arguments, those of form and those of substance. [183] His arguments of form are as follows :

- As the consideration emanates from the offeror, and not from the offeree company, there is no genuine reduction of capital. This is borne out by the fact that despite having its share capital reduced, the offeree company's assets remain intact. [184]
- Despite paying the consideration to the minority shareholders of the offeree company, the offeror is not a party to the reduction of capital proceedings. [185]

Katz's arguments of substance can be summarised as follows :

- A takeover offer has substantial commercial implications for the minority shareholders of the offeree company who are divested of their shares against their will, receiving another asset as consideration which they did not choose. [186]
- He submits that the expropriation of shares in an offeree company should only be achieved by way of consent of the relevant shareholders or the use of an express

[181] H S Cilliers *et al Korporatiewe Reg* 2nd Edition (1992) 463
[182] M M Katz "Legal Aspects of the Regulation of Take-overs" (1979) *Modern Business Law* 56 - 57
[183] M M Katz "Legal Aspects of the Regulation of Take-overs" (1979) *Modern Business Law* 56
[184] M M Katz "Legal Aspects of the Regulation of Take-overs" (1979) *Modern Business Law* 56
[185] M M Katz "Legal Aspects of the Regulation of Take-overs" (1979) *Modern Business Law* 56
[186] M M Katz "Legal Aspects of the Regulation of Take-overs" (1979) *Modern Business Law* 56

framework for the achievement of such an enforced expropriation. [187] The Companies Act [188] has only provided two frameworks for an enforced expropriation of shares namely the provisions of what is now chapter XVA and the Code, and the provisions of a section 311 scheme of arrangement. [189]

- The reason for limiting the compulsory expropriation procedures was to ensure adequate protection for minority shareholders. [190] In view of these facts, Katz is of the opinion that, as the reduction of capital procedure does not provide the same protection to minority shareholders as the other available procedures, the reduction of capital procedure is not a competent or desirable method of achieving a takeover. In his view the possible stamp duty saving occasioned by the reduction of capital method was not a sufficient reason to sacrifice the interests of minority shareholders. [191]

Although Katz readily concedes that there is "eminent legal authority" contrary to his point of view, it is submitted that his view was the correct one in the interests of shareholder protection. Whether this still holds true in the current dispensation will be dealt with later in this section.

An important aspect for consideration is the relationship between the scheme of arrangement procedure and the reduction of capital method. The relationship between these two methods was discussed in *Ex Parte NBSA Centre Ltd.* [192] In his judgement, [193] Coetzee DJP stated that "once one has to resort to section 84 of the [Companies] Act to effect a reduction of capital, it seems to follow that there is no

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[187] M M Katz "Legal Aspects of the Regulation of Take-overs" (1979) *Modern Business Law* 56
[188] Companies Act 61 of 1973
[189] M M Katz "Legal Aspects of the Regulation of Take-overs" (1979) *Modern Business Law* 56
[190] M M Katz "Legal Aspects of the Regulation of Take-overs" (1979) *Modern Business Law* 56
[191] At 57
[192] 1987 (2) SA 783 (T)
[193] At 792

longer room for the application of section 311 unless this is merely part of a larger scheme which can only be accommodated under this section, and of which the reduction procedure is a condition precedent to its functioning". In the course of his judgement [194] he also referred to the English case of *Re Robert Stephen Holdings Ltd* [195] where Plowman J held that it is desirable to proceed by way of scheme of arrangement where the reduction of capital involves one part of a class of shareholders being treated differently from another part of the same class. Plowman J referred to this as the "usual practice" as this procedure afforded better protection to minority shareholders than the reduction of capital procedure.

In so far as South African textbook writers, such as Cilliers and Benade and Henochsberg, cite *Re Robert Stephen Holdings Ltd* [196] as authority for the proposition that in these cases the section 311 [197] procedure can be utilised to the exclusion of the statutory reduction of capital procedure, Coetzee DJP confessed "to being mystified by these statements". [198] The learned Judge referred to this as "utter nonsense". [199] Sections 83 to 88 [200] govern reduction of capital in "clear peremptory terms" and there is no way that this kind of reduction can be achieved in any other shape or form, be it in purported scheme of arrangement fashion or any other.

Coetzee DJP reiterated [201] that "no Court has the power to effect this reduction [of capital] by any other route and if it purports to do so its order is similarly a nullity as it has no jurisdiction to fly in the face of clear and peremptory statutory enactments".

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[194] At 792
[195] [1968] 1 All ER 195 (Ch) at 196
[196] [1968] 1 All ER 195 (Ch)
[197] Companies Act 61 of 1973
[198] At 794
[199] At 794
[200] Act 61 of 1973
[201] At 795

The above views of Coetzee DJP should be compared to that of an earlier case. In *Ex Parte Natal Coal Exploration Co Ltd* [202] Stegmann J interpreted the reference in *Re Robert Stephen Holdings Ltd* to the "better protection" for minority shareholders when using the scheme of arrangement procedure, where the reduction of capital involves one part of a class of shareholders being treated differently from another part of the same class, in a different way to Coetzee DJP in *Ex Parte NBSA Centre Ltd.* [203] He saw the "better protection" and the desirability of the section 311 [204] procedure not as excluding the statutory capital reduction procedure in terms of section 84 of the Companies Act, [205] but as supplementary thereto.

Stegmann J was of the opinion that the two procedures could be used in conjunction and held [206] that the "better protection" afforded by section 311 is at least fourfold. It can be summarised as follows :

- The benefit of a separate meeting for the minority.
- The minority must receive the benefit of a section 312 [207] statement. [208]
- The proposal needs the support of the holders of 75% of the minority shares.
- The size of the minority which is dependant upon the Court's discretion for the protection of its rights is dramatically reduced.

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[202] 1985 (4) SA 279 (W) at 281 - 283
[203] 1987 (2) SA 783 (T)
[204] Of Companies Act 61 of 1973
[205] Companies Act 61 of 1973
[206] At 282
[207] Of Companies Act 61 of 1973
[208] The impact of Rule 29 of the Securities Regulation Code on Take Overs and Mergers will be discussed in section 3.

Coetzee DJP, [209] in turn, stated that he was "not persuaded that the arrangement procedure, however it may be fitted into a reduction of capital procedure, can possibly lead to greater protection." Larkin [210] correctly, it is submitted, questions this statement by Coetzee DJP. Reference was earlier made to Katz [211] who convincingly argued that the scheme of arrangement procedure provides better protection to minority shareholders than the reduction of capital method. The fact that the Court has a discretion in both instances not to confirm the scheme or reduction, does not alter the fact that lesser protection is afforded by the reduction of capital procedure. [212] In any event, the fact remains that the *Natal Coal* approach is preferable i.e. the use of section 311 [213] does not exclude the use of the capital reduction provisions of the Companies Act, [214] but is supplementary thereto in order to provide better protection to minority shareholders.

As will be shown in section 3.5 the Securities Regulation Code on Take-overs and Mergers has been made applicable to takeovers effected by both of these methods. In section 5 it will be shown, however, that the Code is not always applicable and, in these cases, the scheme of arrangement procedure still provides better protection. Even where the Code is applicable the scheme of arrangement procedure provides better protection e.g. the involvement of the Court and the holding of separate meetings by separate classes. The above debate is therefore not only of academic value and the *Natal Coal* approach remains preferable. Katz's views that the scheme of arrangement procedure should be used rather than the reduction of

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[209] In *Ex Parte NBSA Centre Ltd* 1987 (2) SA 783 (T) at 800
[210] M P Larkin "Company Law Legislation" (1987) *Annual Survey of South African Law* 269
[211] M M Katz "Legal aspects of the regulation of take-overs" (1979) *Modern Business Law* 53
[212] For a further discussion on the benefits of the scheme of arrangement procedure see MM Katz "Legal aspects of the regulation of take-overs" (1979) *Modern Business Law* 53
[213] Of Companies Act 61 of 1973
[214] Companies Act 61 of 1973

capital method are, therefore, still valid under the current dispensation in those instances where the Code is not applicable to the relevant transaction. [215]

2.3.4 *Redeemable preference shares method*

A takeover may be effected by converting all the shares in the offeree company not held by the offeror into redeemable preference shares and providing for their redemption from the proceeds of a new issue of shares to the offeror. [216] An example of this procedure is where a holding company wishes to convert a subsidiary into a wholly owned subsidiary. The shares of the non-controlling shareholders are converted into redeemable preference shares by way of special resolution in terms of section 75 (1) (i) of the Companies Act. [217] The offeree company then issues new shares to the holding company in terms of section 98 (1) and (2) of the Act. [218] The proceeds of this issue are then utilised to redeem the preference shares of the non-controlling shareholders resulting in the offeree company becoming a wholly owned subsidiary of the acquiring company. [219]

Although the preference share conversion and redemption technique could be used on its own, it can also be used as an integral part of a scheme of arrangement. In *Ex Parte Garlick Ltd* [220] the offeror wished to obtain the shares of the minority shareholders in the applicant company. A scheme of arrangement was proposed to effect the takeover of the company. The scheme *inter alia* entailed the conversion of ordinary shares into redeemable preference shares. [221] The scheme was opposed

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[215] The impact of Rule 29 of the Securities Regulation Code on Take Overs and Mergers will be considered in section 3.
[216] Section 75 (1) (i), 98 and 99 of the Companies Act 61 of 1973
[217] Companies Act 61 of 1973
[218] Companies Act 61 of 1973
[219] H S Cilliers *et al Korporatiewe Reg* 2nd Edition (1992) 464
[220] 1990 (4) SA 324 (C)
[221] At 330

by one of the minority shareholders *inter alia* upon the grounds that the scheme was not an arrangement between the applicant and its members as required by section 311, [222] it being contended that it was merely an arrangement in terms of which the offeror acquired all the shares in the applicant without the applicant being party to the arrangement. [223] The Court held that: [224]

> "These provisions show that the company is very much a party to the scheme. The scheme which involves a reconstruction of the applicant's capital, without which it cannot be carried into effect, is not merely one between [the offeror] and applicant's shareholders. I am accordingly satisfied that the scheme qualified as an arrangement as contemplated by the section".

The major advantage of the redeemable preference shares method, from the point of view of the offeror, is that it can be implemented without the approval of the Court. This will naturally not be the case if the redeemable preference shares method forms part of a scheme of arrangement. In such a case Court approval will be required.

Although a special resolution, requiring approval by 75% of shareholders, is required for the conversion of the shares, [225] the expropriated minority members could be seriously prejudiced by the exclusion of Court approval. If regard is had to the compelling arguments of Katz, [226] as to why the reduction of capital method should not be allowed to be used to effect a takeover, then *a fortiori* the same applies to this method of effecting a takeover. Of the different methods discussed to date, the

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[222] Of Companies Act 61 of 1973
[223] At 329
[224] At 331
[225] In terms of section 75 (1) of Companies Act 61 of 1973
[226] M M Katz "Legal aspects of the regulation of take-overs" (1979) *Modern Business Law* 53

redeemable preference shares method provides the least amount of protection to minority shareholders. In section 3 of this dissertation the effect of the Securities Regulation Code on Takeovers and Mergers on takeovers, including this method of takeover, will be discussed. Section 5 will deal with the desirability of utilising this method in the current dispensation.

2.3.5 *Sale of assets method*

In his review of mergers and acquisitions for the period from 1976 to 1980, MacGregor [227] lists the purchase of assets as one of the methods utilised by companies involved in merger activities. Although only limited use was made of this method during the relevant period, the Ernst and Young annual M & A survey for 1993 indicated that 25% of transactions during 1993 took the form of purchase of assets rather than the purchase of shares in the offeree company. [228]

If regard is had to the purpose of a takeover, i.e. gaining control over the net assets of a company, the purchase of the assets of a company represents the direct method by which a takeover is effected. In their discussion on the forms and legal mechanics of takeovers, Weinberg and Blank [229] discuss a number of variations of this method. The assets of the offeree company could be bought for cash or in exchange for shares in the offeror. A further variation on the theme is the acquisition of the assets in the offeree company and the "acquiring company" by a third company in exchange for shares in the third company to both the offeree company and the "acquiring company". [230] Should the assets in the offeree

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[227] I H MacGregor *Mergers and Acquisitions in South Africa 1976 - 1977 : A Critical Review* (1977) 12 and I H MacGregor *Mergers and Acquisitions in South Africa 1978 - 1980 : A Critical Review* (1980) 27

[228] Dave Thayser "M & A transactions in SA in 1993" (July 1994) *Accountancy SA 20*

[229] L Rabinowitz *et al Weinberg and Blank on Take-overs and Mergers* 5th Edition (1989) 2003

[230] L Rabinowitz *et al Weinberg and Blank on Take-overs and Mergers* 5th Edition (1989) 2003

company be sold for cash the offeree company is left as a "shell" owning only the cash paid by the offeror while the shareholders of the offeree company remain the same. [231]

The choice to effect a takeover by means of a purchase of assets is not always available to the offeror. When such a choice is available, various considerations might play a role in the choice between the two procedures. A discussion of these considerations, however, falls beyond the scope of this dissertation. [232]

The statutory requirements for a takeover by means of a sale of assets will be discussed in section 4.

2.3.6 *Purchase or exchange of shares*

A company can be taken over by the purchase or exchange of a sufficient number of shares in the offeree company to ensure that control is established. This represents the most obvious and most frequently used method of effecting a takeover in practice. Such a takeover can be accomplished by way of agreement with the majority shareholders of the offeree company, by purchasing sufficient shares on the stock exchange or by means of a takeover bid. [233] A takeover bid is a "general offer made by a person or company to the shareholders of a target company, or to one or more classes of its shareholders, to acquire their shares by purchase or exchange of shares". [234]

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[231] L Rabinowitz *et al Weinberg and Blank on Take-overs and Mergers* 5th Edition (1989) 2029

[232] For a discussion of these considerations and how they impact upon the choice between the two procedures, see PFC Begg *Corporate Acquisitions and Mergers : A Practical Guide to the Legal, Financial and Administrative Implications* 3rd Edition (1991) par 4.12 and SF Reed *et al The Art of M & A : A Merger/Acquisition/Buyout Guide* (1989) 254

[233] W A Joubert (General Editor) *The Law of South Africa* First Reissue Volume 4 Part 1 (1995) Companies by M S Blackman par 253

[234] W A Joubert (General Editor) *The Law of South Africa* First Reissue Volume 4 Part 1 (1995) Companies by M S Blackman par 253

The history of the regulation of takeovers in South Africa will be dealt with in section 3. The former and current regulation of a takeover by means of the purchase or exchange of shares will therefore be dealt with in the succeeding section.

2.3.7 *Other methods*

Apart from the methods discussed in this section, a number of other methods exist by which a takeover can be accomplished. [235] A discussion of these other methods, however, falls outside the scope of this dissertation.

[235] See in this regard the discussions in H S Cilliers *et al Korporatiewe Reg* 2nd Edition (1992) 462 and W A Joubert (General Editor) *The Law of South Africa* First Reissue Volume 4 Part 1 (1995) Companies by M S Blackman par 257

3. REGULATION OF TAKEOVERS IN SOUTH AFRICA

3.1 Position prior to 1991

Until the advent of the Companies Act of 1973 [236] there were no comprehensive statutory provisions governing takeovers and mergers although companies which were listed on the Johannesburg Stock Exchange were subject to the JSE's rules and listing requirements and were contractually bound to observe them under sanction of suspension of their listing or refusal to list new shares. [237]

Under the Companies Act of 1926 [238] two procedures were most frequently used when complete control of an offeree company was desired. [239] These procedures were :

- An ordinary offer to purchase the shares in the offeree company followed by a compulsory acquisition in terms of section 103*ter* of the 1926 Act; [240] and
- An offer incorporated in a scheme of arrangement between the offeree company and its members in terms of section 103 of the 1926 Act. [241]

No formalities in respect of form or content of the ordinary takeover offer were prescribed in the 1926 Act. [242] Neither did the Act [243] prescribe the manner in which such an offer must have been made or accepted. [244] According to De Villiers [245] the

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[236] Companies Act 61 of 1973
[237] Ed Southey "On the legal scene : Take-overs and Mergers under the Microscope" (June 1990) *Accountancy SA 142*
[238] Companies Act 46 of 1926
[239] S W L de Villiers "Take-overs under section 311 to 321 of the Companies Act 1973" (1973) *SALJ* 350
[240] Companies Act 46 of 1926
[241] Companies Act 46 of 1926
[242] Companies Act 46 of 1926
[243] Companies Act 46 of 1926
[244] S W L de Villiers "Take-overs under section 311 to 321 of the Companies Act 1973" (1973) *SALJ* 351
[245] S W L de Villiers "Take-overs under section 311 to 321 of the Companies Act 1973" (1973) *SALJ* 351

offer and acceptance were governed only by the common law of contract. Should such an offer be accepted by a "disinterested majority of shareholders, excluding the offeror, its nominees and/or subsidiaries, holding 90% in value of the shares of the offeree company transfer of which is involved in the takeover", the offeror was entitled to invoke the compulsory acquisition procedure provided for in section 103*ter* of the 1926 Act. [246] The offeror could thus acquire the shares of shareholders who did not accept the takeover offer through the mechanism of section 103*ter* [247] as described above. [248]

Where the offeror did not wish to acquire all the issued share capital of the offeree company, he usually proceeded by way of an ordinary general offer to shareholders of the offeree company to acquire the percentage which he required. [249] Such a partial offer was almost free of any statutory regulation and governed virtually entirely by the common law of contract. [250]

In 1963 a Commission of Enquiry into company law was appointed under the chairmanship of Mr Justice J van Wyk de Vries. The Commission devoted considerable attention to the subject of takeovers in chapter 24 of its Supplementary Report. [251] The Commission considered the question of statutory regulation of takeovers and came to the conclusion that: [252]

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[246] Companies Act 46 of 1926
[247] Of Companies Act 46 of 1926
[248] S W L de Villiers "Take-overs under section 311 to 321 of the Companies Act 1973" (1973) *SALJ* 351
[249] S W L de Villiers "Take-overs under section 311 to 321 of the Companies Act 1973" (1973) *SALJ* 353
[250] S W L de Villiers "Take-overs under section 311 to 321 of the Companies Act 1973" (1973) *SALJ* 353
[251] S W L de Villiers "Take-overs under section 311 to 321 of the Companies Act 1973" (1973) *SALJ* 350
[252] Par 71.04 of the Supplementary Report

"Na 'n deeglike ondersoek van die reg en praktyk aangaande oornames en met inagneming van die getuienis het die Kommissie tot die slotsom gekom dat 'n mate van beheer in die publieke belang noodsaaklik is; soos die reg tans staan word onvoldoende voorsiening vir die verlangde beskerming gemaak juis waar dit die nodigste is."

The Commission also came to the conclusion that a system of voluntary self-discipline, as in the English City Code on Take-overs and Mergers, was not practicable in South Africa. [253] As the Commission considered it unwise to try and deal with every circumstance that could arise in a takeover situation, they recommended that a broad framework of principles should be provided for the regulation of takeovers. [254] Following the recommendations of the Commission section 314 to 321 of the Companies Act [255] were enacted. These sections dealt with the ordinary takeover offer.

In so far as schemes of arrangement were concerned, the Commission expressly dismissed the suggestion that this procedure was being abused to effect compulsory acquisitions, thereby resulting in an avoidance of section 103*ter*. [256] The Commission stated: [257]

[253] Par 70.04 of the Supplementary Report
[254] Par 75.02 of the Supplementary Report and S W L de Villiers "Take-overs under section 311 to 321 of the Companies Act 1973" (1973) *SALJ* 353
[255] Companies Act 61 of 1973
[256] Of Companies Act 46 of 1926
[257] Par 77.01 of the Supplementary Report

"Regtens is die beginsel en die meganisme ingevolge die onderskeie artikels geheel en al verskillend en kan hulle nie vergelyk word nie. Elk van die artikels het 'n verskillende oogmerk, handel met verskillende beginsels, stel verskillende meganismes beskikbaar en bevat verskillende beveiligingsmaatreëls. Die feit dat dieselfde eindresultaat in kommersiële sin in gevolge elk van die artikels bereik kan word, is toevallig en raak nie die regsbeginsels nie".

The Commission therefore clearly intended retaining both the ordinary offer procedure as well as the scheme of arrangement procedure to effect takeovers where complete control of the offeree company was sought. [258]

Section 314 (1) of the new Act [259] defined a "takeover offer" as "an offer for the acquisition of shares under a takeover scheme". A "takeover scheme" was in turn defined as "a scheme involving the making of an offer for acquiring shares of the offeree company which, together with any shares of that company already held by the offeror, would have the effect either (a) of vesting the control of the offeree company directly or indirectly in the offeror or (b) of the offeror acquiring all the shares (or all the shares of a particular class) of the offeree company". [260] The definition did not extend to any offer made in the course of any individual negotiation with a shareholder for the acquisition of any such shares. [261]

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[258] S W L de Villiers "Take-overs under section 311 to 321 of the Companies Act 1973" (1973) *SALJ* 355
[259] Companies Act 61 of 1973
[260] Section 314 (1) of the Companies Act 61 of 1973
[261] W A Joubert (General Editor) *The Law of South Africa* First Reissue Volume 4 Part 1 (1995) Companies by M S Blackman par 258

According to *LAWSA* [262] the definition of "takeover offer" suffered from a number of defects. The first of these defects was that it related only to the "acquisition of shares". [263] As was illustrated earlier in section 2 a takeover can be effected in a number of ways. Those methods not utilising the acquisition of shares were therefore left unregulated, making it possible to circumvent the provisions of section 314 to 321 of the Companies Act. [264] All that was required was for the offeror to obtain the co-operation of the offeree company's board and to utilise the scheme of arrangement, the reduction of capital or the redeemable preference share method. [265] An illustration of this problem was the judgement in *Ex Parte Federale Nywerhede Bpk* [266] where Coetzee J held that as the proposed scheme did not entail an *acquisition* of shares, section 314 of the Companies Act [267] was not applicable. As there was only an *extinguishing* of shares, the takeover provisions did not apply. [268]

Katz [269] was also a proponent of an amended definition of "takeover scheme". He was critical of the "fundamental loophole" of the definition whereby an offeror could gain control of a company by private negotiation and thereafter making an offer to all shareholders except for one holder of a small number of shares. [270] As both these actions fell outside the two tests necessary to constitute a "takeover scheme", the offeror could avoid compliance with the provisions of the Act. [271]

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[262] W A Joubert (General Editor) *The Law of South Africa* First Reissue Volume 4 Part 1 (1995) Companies by M S Blackman par 258
[263] W A Joubert (General Editor) *The Law of South Africa* First Reissue Volume 4 Part 1 (1995) Companies by M S Blackman par 258
[264] Companies Act 61 of 1973
[265] W A Joubert (General Editor) *The Law of South Africa* First Reissue Volume 4 Part 1 (1995) Companies by M S Blackman par 258
[266] 1975 (1) SA 826 (W)
[267] Companies Act 61 of 1973
[268] At 833
[269] M M Katz "Legal aspects of the regulation of take-overs" (1979) *Modern Business Law* 55
[270] M M Katz "Legal aspects of the regulation of take-overs" (1979) *Modern Business Law* 55
[271] Companies Act 61 of 1973

A further defect in the definition related to the ambit of "control". [272] Indirect shareholdings, e.g. shares held by nominees and controlled companies of the offeror, were only taken into account in the context of "vesting control", and not in the context of the acquisition of all the issued shares of the company or in the case of an offer for all the shares of a particular class of the offeree company. [273] It was quite possible that in such instances a change of control might not have been involved. [274] Offers to acquire conversion rights, warrants and options in connection with preference shares and debentures and invitations requesting offers from shareholders to sell their shares were also left beyond the scope of "control", thus making it possible to circumvent the takeover procedures. [275]

The inadequacy of these provisions was highlighted in *Spinnaker Investments (Pty) Ltd v Tongaat Group Ltd.* [276] The Court held that the Legislature, in enacting section 314 to 321, [277] was only dealing with a particular kind of takeover offer. [278] It only related to a "composite offer made to the shareholders of the offeree company .... in contradistinction to an individual negotiation with a shareholder for the acquisition of his shares". [279] Secondly, it only related to a "takeover offer made under a takeover scheme, and the scheme must be one which, if implemented, will at the time of making the offer have the effect" as defined. [280] If the takeover scheme does not involve the making of an offer for shares by the offeror which at the time of making the offer will have the prescribed effect, the provisions of section 314 [281] will have no

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[272] W A Joubert (General Editor) *The Law of South Africa* First Reissue Volume 4 Part 1 (1995) Companies by M S Blackman par 258
[273] S W L de Villiers "Take-overs under sections 311 to 321 of the Companies Act 1973" (1973) *SALJ* 357
[274] S W L de Villiers "Take-overs under sections 311 to 321 of the Companies Act 1973" (1973) *SALJ* 357
[275] W A Joubert (General Editor) *The Law of South Africa* First Reissue Volume 4 Part 1 (1995) Companies by M S Blackman par 357 - 358
[276] 1982 (1) SA 65 (A) at 73
[277] Of Companies Act 61 of 1973
[278] At 73
[279] At 73
[280] At 73
[281] Of Companies Act 61 of 1973

application to the transaction. [282] The Court concluded [283] that "it will be seen that two factors are of critical importance : it must be established what the effect of the offer will be, and that effect must be ascertained, not at any time, but at the time when the offer is made."

LAWSA [284] concludes that "the most important criticism against the provisions contained in the Companies Act dealing with takeovers was that no provision was made for the establishment of a body to administer, make regulations under, and enforce the statutory scheme." It must however be stated that even had such a body been established, it would have been unlikely to have been successful in light of the fatal flaws in the relevant legislation. A total re-examination of present legislation was required to deal with this aspect of company law.

3.2 Introduction of the Securities Regulation Panel

These problems with the system of takeover regulation led to an investigation by the Standing Advisory Committee on Company Law. Their brief was to recommend possible reform measures to alleviate these problems. In a memorandum to the Committee by Mr Justice C S Margo and F J Naudé four options were considered, namely : [285]

(i) Detailed and comprehensive statutory provision in the Companies Act;

(ii) The creation of a governmental agency with rule-making powers;

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[282] At 73
[283] At 73
[284] W A Joubert (General Editor) *The Law of South Africa* First Reissue Volume 4 Part 1 (1995) Companies by M S Blackman par 258
[285] C S Margo and S J Naudé "Takeovers and Mergers : The City Panel and the Position in South Africa (Report to the Standing Advisory Committee on Company Law)" in *Modern Business Law* (1983) 122 at 127

(iii) Leaving the responsibility with the JSE;

(iv) The establishment of a Takeover Panel on the basis of self regulation, with or without a statutory framework.

The first option was rejected as "it would impose rigidity which would tend to stultify rather than promote the economy." [286] It was felt that it could not cover, "with the essential flexibility", all situations that may arise in takeovers and mergers. [287] The second option was rejected because "the establishment of an effective Securities and Exchange Commission [based on the American model] appears to be beyond the resources of our country". [288] The third option was likewise rejected as it was felt that an approach, leaving the important area of shareholder protection in takeover situations in the hands of a stock exchange, was inappropriate. [289] Such protection involves policy decisions on difficult questions and, it was felt, this could not reasonably be expected to be "shouldered" by the JSE and its Listings Committee. [290]

The Committee thus opted for the fourth option, the establishment of a Takeover Panel. [291] They further recommended that such a Panel be established within a statutory framework rather than the self regulating model of the London Panel as it was felt that completely voluntary self-discipline is not practical in South Africa. [292]

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[286] C S Margo and S J Naudé "Takeovers and Mergers : The City Panel and the Position in South Africa (Report to the Standing Advisory Committee on Company Law)" in *Modern Business Law* (1983) 127

[287] C S Margo and S J Naudé "Takeovers and Mergers : The City Panel and the Position in South Africa (Report to the Standing Advisory Committee on Company Law)" in *Modern Business Law* (1983) 127

[288] C S Margo and S J Naudé "Takeovers and Mergers : The City Panel and the Position in South Africa (Report to the Standing Advisory Committee on Company Law)" in *Modern Business Law* (1983) 128

[289] C S Margo and S J Naudé "Takeovers and Mergers : The City Panel and the Position in South Africa (Report to the Standing Advisory Committee on Company Law)" in *Modern Business Law* (1983) 129

[290] C S Margo and S J Naudé "Takeovers and Mergers : The City Panel and the Position in South Africa (Report to the Standing Advisory Committee on Company Law)" in *Modern Business Law* (1983) 129

[291] C S Margo and S J Naudé "Takeovers and Mergers : The City Panel and the Position in South Africa (Report to the Standing Advisory Committee on Company Law)" in *Modern Business Law* (1983) 129

[292] C S Margo and S J Naudé "Takeovers and Mergers : The City Panel and the Position in South Africa (Report to the Standing Advisory Committee on Company Law)" in *Modern Business Law* (1983) 129

Following the recommendations of the Standing Advisory Committee on Company Law sections 314 to 321 [293] as well as section 224, [294] which prohibited directors from dealing in options in respect of listed shares and debentures, and sections 229 to 233, [295] dealing with insider trading, were repealed. [296] These provisions were replaced by a new chapter [297] in the Companies Act, entitled "Regulation of Securities". The new chapter XVA was inserted by section 4 (a) of the Companies Amendment Act. [298]

Section 440B(1) of the Companies Act [299] established the Securities Regulation Panel. The Panel is a body corporate with members appointed by the Minister. [300] Section 440B(2) [301] determines who must be included within the ranks of these members. The function of the Panel is to regulate "affected transactions" or proposals that will, if completed, be "affected transactions". [302] In terms of section 440C(1)(b) it also supervises dealings in "securities", as defined in section 440A. [303]

In terms of Section 440C(3) [304] the Panel is empowered to make rules for the regulation of "affected transactions". The chapter further contains a prohibition against insider trading. [305]

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293 Of Companies Act 61 of 1973
294 Of Companies Act 61 of 1973
295 Of Companies Act 61 of 1973
296 In terms of section 6 of the Companies Amendment Act 78 of 1989
297 Chapter XVA
298 Companies Act 78 of 1989
299 Companies Act 61 of 1973
300 Section 440B (1) and (2)
301 Of Companies Act 61 of 1973
302 Section 440C (1) (a)
303 Of Companies Act 61 of 1973
304 Of Companies Act 61 of 1973
305 Section 440F

The provisions of chapter XVA [306] were amended by the Companies Second Amendment Act of 1990. [307] A provision prohibiting a person from entering into an "affected transaction", as defined in section 440A, [308] except in accordance with the rules was *inter alia* introduced by the Amendment Act. [309] This prohibition was contained in the new section 440L [310]. Section 440M [311], in turn, empowered the Panel to apply to Court to obtain certain specified remedies where a person who is not exempted from the rules contravenes or threatens to contravene them. A new provision [312] prohibiting insider trading and a provision empowering the Panel to require certain holders of equity securities to make disclosure to it of such holdings were also inserted. [313] Section 440K [314] re-introduced the compulsory acquisition provisions, suitably amended, to the Companies Act. [315]

3.3 Securities Regulation Code

The Securities Regulation Panel compiled the Securities Regulation Code on Takeovers and Mergers under section 440C (3) and (4) of the Companies Act. [316] The Code was promulgated on 18 January 1991. [317] In terms of Rule 36.1 the Code applies to "affected transactions" entered into with effect from 1 February 1991.

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306 Of Companies Act 61 of 1973
307 Companies Act 69 of 1990
308 Of Companies Act 61 of 1973
309 Companies Act 69 of 1990
310 Of Companies Act 61 of 1973
311 Of Companies Act 61 of 1973
312 Section 440F
313 Section 440G
314 Of Companies Act 61 of 1973
315 Companies Act 61 of 1973
316 Companies Act 61 of 1973
317 In terms of GNR 29 in Government Gazette No 12962

According to the Explanatory Notes to the Code [318] the Code is based on the City Code on Takeovers and Mergers issued by the London Panel on Takeovers and Mergers. Its purpose is to ensure that all holders of relevant securities affected by a takeover or merger are treated fairly and equally. [319] The principle of self regulation by the securities industry finds expression in the Code, which in South Africa, unlike the position in England, enjoys the force of law. [320] This is clear from section 1(c) of the Code - *Enforcement of the Code* which refers to the statutory powers of the Panel to enforce the Code.

The Code is divided into general principles, setting out acceptable standards of commercial behaviour, and rules, containing examples of the application of the general principles as well as the procedural requirements to be followed. [321] The general principles endeavour to embody the principle of equality of treatment of all holders of the same class of securities by requiring the furnishing of all information necessary to ensure equality of information, [322] a careful and responsible consideration of announcements of offers or announcements of an intention to make an offer and preparation of documents and advertisements, [323] the supply of sufficient information and advice, and the granting of sufficient time to enable an informed decision to be made. [324] It also requires the avoidance of the creation of false markets, [325] the prohibition of the frustration of *bona fide* offers, [326] and the oppression of minorities, [327] as well as requiring the disregard of directors' personal interests when advising the holders of relevant securities. [328] The Code further

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[318] Section 1 (a) of the Code - *Nature and Purpose of the Code*
[319] Section 1 (a) of the Code - *Nature and Purpose of the Code*
[320] Section 1 (c) of the Code - *Enforcement of the Code*
[321] Section A - *Introduction*, Par 2 - *The Code in Practice*
[322] General Principle 1 and 2 in section C of the Code
[323] General Principle 3 and 5 in section C of the Code
[324] General Principle 4 in section C of the Code
[325] General Principle 6 in section C of the Code
[326] General Principle 7 in section C of the Code
[327] General Principle 8 in section C of the Code
[328] General Principle 9 in section C of the Code

requires the offeror in an "affected transaction" to make an identical offer (or where this is not possible, an equivalent cash offer) to acquire the securities of those holders of relevant securities who were not involved in the "affected transaction". [329]

The Companies Act [330] empowers the Panel to enforce its rules by application to Court for an order for specific performance and/or for an interdict and/or for a declaratory order. [331] Section 1(c) - *Enforcement of the Code* in the Explanatory Notes further provides that the Panel can enforce the Code "by notification to interested parties and/or by general publication of an announcement that the requirements of the Code have not been complied with and/or that a particular offer is not or was not valid, with the consequences flowing therefrom".

3.4 Transactions and companies to which the Code apply

Subject to any exemption by the Panel, no person may enter into or propose an "affected transaction" except in accordance with the rules made or amended from time to time by the Securities Regulation Panel. [332] An "affected transaction" is defined [333] as "any transaction (including a transaction which forms part of a series of transactions) or scheme, whatever form it may take, which :

a. taking into account any securities held before such transaction or scheme, has or will have the effect of :

   (i) vesting control of any company (excluding a close corporation) in any person, or two or more persons acting in concert, in

[329] General Principle 10 in section C of the Code
[330] Companies Act 61 of 1973
[331] Section 440M of the Companies Act 61 of 1973
[332] Section 440L of the Companies Act 61 of 1973
[333] Section 440A (1) of the Companies Act 61 of 1973.

whom control did not vest prior to such transaction or scheme; or

(ii) any person, or two or more persons acting in concert, acquiring, or becoming the sole holder or holders of, all the securities, or all the securities of a particular class, of any company (excluding a close corporation) ; or

b. involved the acquisition by any person, or two or more persons acting in concert, in whom control of any company (excluding a close corporation) vests on or after the date of commencement [334] of section 1 (c) of the Companies Second Amendment Act, 1990, of further securities of that company in excess of the limits prescribed in the rules."

In turn, "control" means "a holding or aggregate holdings of shares or other securities in a company entitling the holder to exercise, or cause to be exercised, the specified percentage or more of the voting rights at meetings of that company, irrespective of whether such holding or holdings confer *de facto* control." [335] "Specified percentage" is the percentage prescribed in the rules for the purposes of determining control. [336] The specified percentage may in no case fall below 20% of the issued securities of any class. [337] In terms of paragraph 5 of section B - *Definitions* of the Code the original specified percentage was established at 30% or more of the voting rights of a company. The specified percentage is at present 35% or more of the voting rights of a company. [338]

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[334] 1 February 1991
[335] Section 440A (1) of the Companies Act 61 of 1973
[336] Section 440A (1) of the Companies Act 61 of 1973
[337] Section 440A (1) of the Companies Act 61 of 1973
[338] Government Gazette 15050 R1522 of 13 August 1993.

The above definition of an "affected transaction" refers to the concept of persons "acting in concert". Section 440A (2) (a) [339] contains certain deeming provisions as to when persons are deemed to be "acting in concert".

It is the nature of the company "which is the offeree or potential offeree or in which control (as defined) may change" that determines whether or not the Securities Regulation Code on Takeovers and Mergers applies. [340] The Code applies where the offeree company is a "public company, whether or not listed on the Stock Exchange, or a statutory corporation, which is or is deemed to be resident in the Republic". [341] The Code also applies where the offeree company is a "private company which is or which is deemed to be resident in the Republic but only where the shareholders' interests, valued at the offer price, and the shareholders' loan capital, exceed R5 million and there are more than 10 beneficial shareholders". [342] Rule 34 of the Code empowers the Panel to "authorise, subject to such terms and conditions as it may prescribe, non-compliance with or departure from any requirement of the Code and to excuse or exonerate any party from failure to comply with any such requirement."

Based on the above exposition it is clear that the establishment of the Securities Regulation Panel was aimed at the regulation of mergers and takeovers and the protection of all holders of relevant securities. This protection is, however, only available if the relevant transaction qualifies as an "affected transaction", as defined in section 440A. [343]

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[339] Of Companies Act 61 of 1973
[340] Par 3 - *Companies To Which The Code Applies* of Section A - *Introduction* of the Code
[341] Par 3 - *Companies To Which The Code Applies* of Section A - *Introduction* of the Code
[342] Par 3 - *Companies To Which The Code Applies* of Section A - *Introduction* of the Code
[343] Of Companies Act 61 of 1973

3.5 Effect of the Code on methods of achieving a takeover

The Code has not only significantly altered the regulation of takeovers effected by means of a purchase or exchange of shares. It has also had a significant effect on takeovers effected by the scheme of arrangement, reduction of capital and redeemable preference shares methods. Rule 29 (a) (iv) reads as follows :

> "(a) Where an offer is implemented by a scheme of arrangement or by a reduction of capital or conversion of securities or any other method, then, for the purposes of these Rules -...
>
> (iv) save in so far as the Panel may otherwise permit, or unless the Supreme Court has ordered otherwise, the provisions of these Rules relating to the disclosure and, where possible, timing and periods of notice shall apply *mutatis mutandis*."

From the above it is evident that the extensive provisions of the Code, as *inter alia* enunciated in paragraph 3.3, [344] relating to compulsory disclosure requirements, providing adequate time to consider offers and related matters are also made applicable to the scheme of arrangement, reduction of capital and redeemable preference shares methods to effect a takeover. By including these methods of effecting takeovers within the ambit of the Code, the Legislature has made its intention clear that shareholder protection must be statutorily entrenched irrespective of the method chosen to effect a takeover. The power of the Court and the Panel to allow a deviation from the provisions of the Code is, however, retained. It is

[344] See e.g. Rule 2, 3, 6, 7, 14, 16, 20, 21, 22, 23, 24, 27, 28, 30, 32

submitted that very good cause will have to be shown by the proponent of such a deviation before a Court or the Panel will make such an order.

The effect of Rule 29 of the Code on these methods is that the Panel will police the Code and ensure that all its provisions are adhered to by parties to a takeover. Where necessary, the Panel may approach the Court to enforce the provisions of the Code. On the other hand, the Court still retains its role in sanctioning the relevant scheme of arrangement or reduction of capital in terms of section 311 and 84 of the Companies Act. [345] The Court therefore retains its role in shareholder protection as it still has the discretion to refuse an application to sanction a scheme of arrangement or reduction of capital. The Court must still determine whether the provisions of section 311 or 84 of the Companies Act [346] have been adhered to by the parties to the proposed takeover. It is submitted that the Court will also refuse an application to sanction a scheme of arrangement or reduction of capital if the provisions of the Code have not been complied with. The Panel and the Court are therefore partners in shareholder protection during takeovers.

Rule 29(b) of the Code further states that "in the case of a reduction of capital or a conversion of securities which has as its purpose the elimination of a minority shareholding, the Panel may in appropriate circumstances require that at the relevant meetings the majority votes shall be excluded." Unfortunately the Code does not give any indication as to what would constitute "appropriate circumstances." What is significant, however, is that the Panel is given the power to exclude the votes of a majority where the purpose of the reduction of capital or conversion of securities is to eliminate minority shareholdings.

[345] Companies Act 61 of 1973
[346] Companies Act 61 of 1973

The introduction of Rule 29(b) of the Code raises a number of pertinent questions. These questions include the following :

- What is the "relevant meeting"?
- What is meant by "majority votes"? Whose votes will be excluded?
- Will the exclusion be dealt with in the same way as in section 440K(1)? [347]
- Why have schemes of arrangement been excluded from this Rule?
- How will the exclusion of majority votes affect the passing of the required special resolution?

The above questions currently remain unanswered and it is submitted that legislative amendment is required to clarify these issues. No answers are readily available and, should the interpretation of this Rule be left to the Courts, it is submitted that the role and ambit of Rule 29 of the Code could be shrouded in uncertainty.

It is submitted that this power of the Panel to exclude the majority votes should be exercised sparingly so as not to create a veto right for minorities as there are often sound commercial reasons for a takeover. What must be kept in mind is that section 252 of the Companies Act [348] is still available to minority shareholders to protect their interests and to prevent undue oppression of minorities. In terms of section 252 [349] the Court has a very wide discretion to make any suitable order to prevent oppression of minority shareholders. On the other hand, it will be conceded that the Panel, representing the collective opinion and standards of the securities industry, is often better positioned than a Court to determine what constitutes acceptable

[347] Of Companies Act 61 of 1973
[348] Companies Act 61 of 1973
[349] Of Companies Act 61 of 1973

behaviour on the side of majority shareholders during a takeover. In view of this fact this provision in the Code is welcomed as another tool in the interest of minority protection.

4. EXCLUSION OF ASSET TAKEOVERS FROM THE DEFINITION OF "AFFECTED TRANSACTION"

4.1 Introduction

In 1980 MacGregor [350] expressed criticism against the anomalous position that the same protection was not afforded to all shareholders irrespective of the method employed to effect a takeover. The Legislature attempted to remedy this problem with the introduction of the Securities Regulation Panel and Code. As explained above, all "affected transactions" [351] are included within the ambit of the Code. "Affected transaction" is defined in the Act as "any transaction or scheme, *whatever form it may take* [352]...". [353] The intention was clearly to bring neutrality of treatment whatever method is employed to effect a takeover. However, a transaction can only be an "affected transaction" if it relates to "securities". [354] A "security" is defined in section 440A (1) of the Companies Act [355] as meaning "any shares in the capital of a company and includes stock and debentures convertible into shares and any rights or interests in a company or in respect of any shares, stock or debentures, and includes any "financial instrument" as defined in the Financial Markets Control Act, 1989". A takeover by means of the purchase of assets is therefore not included.

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[350] I H MacGregor *Mergers and Acquisitions in South Africa 1978 - 1980 : A Critical Review* (1980) 28
[351] As defined in section 440A of Act 61 of 1973
[352] My emphasis
[353] Section 440A (1) of the Companies Act 61 of 1973.
[354] In terms of the definition of "affected transaction" in section 440A (1) of the Companies Act 61 of 1973
[355] Companies Act 61 of 1973

4.2 Section 228 of the Companies Act

A disposal of assets by a company is regulated by section 228 of the Companies Act [356] if the requirements of the section, relating to the portion of the assets being alienated, are met. It is therefore important to look at the nature and purpose of this section.

Section 228 of the Companies Act [357] determines that "notwithstanding anything contained in the memorandum or articles, the directors of a company shall not have the power, save with the approval of a general meeting, to dispose of (a) the whole or substantially the whole of the undertaking of the company, or (b) the whole or the greater part of the assets of the company". In order to be effective the resolution approving such disposal must specifically authorise or ratify the transaction in question. [358] Section 228 of the Act [359] therefore imposes a limitation not on the capacity of a company but on the authority of the directors. [360]

In *Levy v Zalrut Investments* [361] the Court had an opportunity to pronounce upon the nature of section 228. [362] It was stated that: [363]

> "The intention of the Legislature in enacting section 228 was to place a limitation on the powers of the directors of a company in respect of the disposal of the whole or major portion of its undertaking or assets and was

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356 Companies Act 61 of 1973
357 Companies Act 61 of 1973
358 Section 228 (2) of Act 61 of 1973
359 Companies Act 61 of 1973
360 P E J Brooks "Section 228 of the Companies Act" (May 1987) *THRHR* 226
361 1986 (4) SA 479 (W)
362 Of Companies Act 61 of 1973
363 At 484 - 485

introduced with a view to regulating the procedure required for a disposal described therein and as such it was clearly designed for the benefit of the shareholders."

The purpose of section 228 of the Companies Act [364] is the protection of shareholders of a company against potential alienation of company assets by the directors of the company. [365] Unlimited alienation of assets will not only change the nature of the company but may also place the company in a position where it is unable to continue trading. [366] The intention of the Legislature to provide statutory protection to shareholders by means of section 228 [367] also emerges clearly from earlier decisions such as *Sugden v Beaconhurst Dairies (Pty) Ltd* [368] where it was stated that "its purpose ... was to secure a measure of protection for shareholders".

A great deal of criticism has been levelled at section 228 [369] and calls have been voiced for the removal of section 228 from the Act. [370] The most serious criticism of the section is the invidious position of a third party who may suffer prejudice as a result of the operation of a provision designed for the protection of shareholders. [371] This has led to a recommendation in the Minority Report [372] of the Van Wyk De Vries Commission [373] that the predecessor of section 228, [374] section 70*dec* (2), [375] be

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364 Companies Act 61 of 1973
365 Michele von Willich "Die Uitwerking van Artikel 228 van die Maatskappywet 61 van 1973 op die Turquand-reël" (March 1988) *Modern Business Law* 12
366 Michele von Willich "Die Uitwerking van Artikel 228 van die Maatskappywet 61 van 1973 op die Turquand-reël" (March 1988) *Modern Business Law* 12
367 Of Companies Act 61 of 1973
368 1963 (2) SA 174 (T) at 179
369 Of Companies Act 61 of 1973
370 Companies Act 61 of 1973; See e.g. Ribbens "Disposal of the Undertaking or the Whole or Greater Part of the Assets of a Company" (1976) THRHR 169; Hodes "Disposal of Assets" (1978) SACLJ F-14; Von Willich "Die uitwerking van Artikel 228 van die Maatskappywet 61 van 1973 op die Turquand-reël" (1988) *Modern Business Law* 14.
371 Michele von Willich "Die Uitwerking van Artikel 228 van die Maatskappywet 61 van 1973 op die Turquand-reël" (March 1988) *Modern Business Law* 12
372 Annexure C par 9.60
373 Main Report RP 45/1970
374 Of Companies Act 61 of 1973
375 Of Companies Act 46 of 1926

scrapped. The objection to section 228, [376] according to its critics, is that it is unfair towards a third party to nullify an agreement of sale between such a third party and the directors of a company based on the fact that the necessary section 228 [377] approval has not been obtained. It is argued that there should be no duty on a *bona fide* third party to establish whether the necessary resolution had been passed by the company. A discussion of this aspect of section 228 [378] and the relationship of section 228 [379] with the Turquand rule, however, falls beyond the scope of this discussion. [380] What should be kept in mind is that a lobby exists for the removal of section 228 [381] which would result in an even more detrimental situation for minority shareholders in the case of takeovers by means of asset purchases *vis-a-vis* other forms of takeover.

The question needs to be answered whether it is advisable that a section 228 [382] sale of assets be included in the definition of an "affected transaction", thus making the Code applicable to such transactions. This question needs to be answered against the background of the fact that there is a danger of overstating the case for safeguards for minorities. It must be kept in mind that protection is a form of interference with free market forces. [383] The question whether controlling shareholders should be allowed to expropriate minorities through any legal means was considered in the cases of the expropriation of minority shareholders in *Micor* and *Racy*, two public companies listed on the Johannesburg Stock Exchange, in 1993. [384]

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[376] Of Companies Act 61 of 1973
[377] Of Companies Act 61 of 1973
[378] Of Companies Act 61 of 1973
[379] Of Companies Act 61 of 1973
[380] For a further discussion on this relationship, see Michele von Willich "Die Uitwerking van Artikel 228 van die Maatskappywet 61 van 1973 op die Turquand-reël" (March 1988) *Modern Business Law* 12
[381] Of Companies Act 61 of 1973
[382] Of Companies Act 61 of 1973
[383] Ann Crotty "Minority Close-out : Protection needed for an endangered species" (14 January 1993) *Finance Week* 36
[384] Ann Crotty "Minority Close-out : Protection needed for an endangered species" (14 January 1993) *Finance Week* 36

The expropriation transaction was implemented by way of section 228 of the Companies Act.[385] The assets of the company were sold, converting the company into a cash shell. As the shares were not sold, but the assets, this transaction did not fall within the ambit of the Code.[386] Given the position of the controlling shareholders in *Racy* and *Micor*, *inter alia* that their public profile was of little value to them, and public criticism was therefore not a major concern, utilising the section 228[387] procedure seemed to be understandable.[388] It represented a method of takeover which was time and cost effective.[389] However, it is difficult to condone the manner in which minority shareholders were expropriated from the business of *Racy*.[390]

According to Crotty[391] the general feeling in the market was that this sort of use of section 228[392] represented a complete abuse of minority rights. The more so when, as in *Racy's* and *Micor's* case, the directors who were selling the businesses were also directors of the buying companies involved. As section 228[393] was used, the only remedy open to these minorities was an application in terms of section 252 of the Companies Act[394] as both the JSE and the Securities Regulation Panel, which would normally be responsible for the protection of minority rights, had no authority to intervene.

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385 Companies Act 61 of 1973
386 Ann Crotty "Minority Close-out : Protection needed for an endangered species" (14 January 1993) *Finance Week* 36
387 Of Companies Act 61 of 1973
388 Ann Crotty "Minority Close-out : Protection needed for an endangered species" (14 January 1993) *Finance Week* 36
389 Ann Crotty "Minority Close-out : Protection needed for an endangered species" (14 January 1993) *Finance Week* 36
390 Ann Crotty "Minority Close-out : Protection needed for an endangered species" (14 January 1993) *Finance Week* 36
391 Ann Crotty "Minority Close-out : Protection needed for an endangered species" (14 January 1993) *Finance Week* 37
392 Of Companies Act 61 of 1973
393 Of Companies Act 61 of 1973
394 Companies Act 61 of 1973

None of the majority shareholders were contravening any of the JSE's listing requirements, and in terms of the Securities Regulation Code the transaction could not be defined as an "affected transaction" as there was no sale of securities and therefore fell outside the jurisdiction of the Panel. In terms of section 252 of the Companies Act [395] a shareholder may approach the Court for assistance if "any particular act or omission of a company is unfairly prejudicial, unjust or inequitable". Section 252 [396] was primarily designed to protect minority shareholders from oppression by majority shareholders. However, according to Crotty, the risk, time and cost involved have resulted in section 252 [397] not often being used by minority shareholders. [398] Whether section 252 [399] constitutes a sufficient remedy to minority shareholders will be reverted to later on.

It is for these reasons that the use of section 228 [400] is an attractive option to majority shareholders. Implementing a takeover by means of the section 228 [401] procedure does not constitute an "affected transaction", neither does this procedure contravene any JSE listing requirement.

As a number of companies were considering following the example of *Racy* and *Micor*, the JSE, the Securities Regulation Panel and the Standing Advisory Committee on Company Law were looking for a way either to prevent this use of section 228 [402] or bring it under the jurisdiction of the Panel. [403]

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[395] Companies Act 61 of 1973
[396] Of Companies Act 61 of 1973
[397] Of Companies Act 61 of 1973
[398] Ann Crotty "Minority Close-out : Protection needed for an endangered species" (14 January 1993) *Finance Week* 37
[399] Of the Companies Act 61 of 1973
[400] Of Companies Act 61 of 1973
[401] Of Companies Act 61 of 1973
[402] Of Companies Act 61 of 1973
[403] Ann Crotty "Minority Close-out : Protection needed for an endangered species" (14 January 1993) *Finance Week* 37

4.3 Recommendation by the SAC

In terms of Rule 29 of the Securities Regulation Code the Code applies whether an offer [404] is implemented by a scheme of arrangement or by a reduction of capital or conversion of securities or *any other method*. Section 440L [405] also determines that "subject to any exemption by the Panel, no person shall enter into or propose an "affected transaction" except in accordance with the rules." However, as Larkin [406] correctly points out, Rule 29 cannot cure the Panel's lack of jurisdiction over an acquisition of the assets of the offeree company. There is no statutory sanction for such jurisdiction and one cannot cure this by resort to the "spirit" of the Code. [407] This statement is in fact not disproved by the ABSA takeover of the Allied Group as that transaction, correctly construed, did not involve only an assets acquisition. [408]

According to Larkin [409] fears have been expressed that the two worlds which the new securities legislation seeks to straddle, i.e. statutory regulation and self regulation, are too far apart for this to be able to be done successfully. This problem is illustrated by the fact that the Panel has not been empowered to have authority in a situation where a company's assets are taken over rather than its shares. [410]

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404 Defined in section B of the Code as including "an offer in respect of an affected transaction, however effected".
405 Of Companies Act 61 of 1973
406 M P Larkin "Company Law Legislation" (1991) *Annual Survey of South African Law* 212
407 M P Larkin "Company Law Legislation" (1991) *Annual Survey of South African Law* 212
408 M P Larkin "Company Law Legislation" (1991) *Annual Survey of South African Law* 212
409 M P Larkin "Company Law Legislation" (1990) *Annual Survey of South African Law* 270
410 M P Larkin "Company Law Legislation" (1990) *Annual Survey of South African Law* 270

During 1993 the Standing Advisory Committee on Company Law ("the SAC") recommended to the Minister of Finance and of Trade and Industry that the Companies Act [411] be amended to include in the definition of an "affected transaction":

> "a disposal which is governed by section 228 of the [Companies] Act where the purchaser is unrelated to the seller". [412]

The *ratio* behind the SAC's recommendation was the protection of minority shareholders. The current exclusion of a disposal of assets in terms of section 228 of the Companies Act [413] is one reason why there is no "neutrality of treatment in respect of all corporate combinations". [414] It was the view of the SAC that it was necessary to include such a section 228 [415] disposal within the definition of "affected transaction" to ensure such neutrality of treatment by also bringing this method within the ambit of the Securities Regulation Code on Takeovers and Mergers. [416]

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[411] Companies Act 61 of 1973

[412] J A K Jarvis "Protection for Minority Shareholders - Section 228 of the Companies Act - Recommendations by the Standing Advisory Committee on Company Law" (June 1993) *De Rebus* 481

[413] Companies Act 61 of 1973

[414] J A K Jarvis "Protection for Minority Shareholders - Section 228 of the Companies Act - Recommendations by the Standing Advisory Committee on Company Law" (June 1993) *De Rebus* 481

[415] Of Companies Act 61 of 1973

[416] J A K Jarvis "Protection for Minority Shareholders - Section 228 of the Companies Act - Recommendations by the Standing Advisory Committee on Company Law" (June 1993) *De Rebus* 481

4.4 Conceptual problems with SAC recommendation

According to Jarvis [417] there are two aspects of the recommendation by the SAC which require comment. The first relates to the determination of which of the transactions governed by the provisions of section 228 [418] should be incorporated in the definition of an "affected transaction". The second relates to the requirements of the Code and the powers of the Panel in relation to a transaction governed by section 228 [419] which falls in the definition of an "affected transaction". [420]

In relation to the first aspect, the SAC recommendation is to include a disposal which is governed by section 228 of the Act [421] where "the purchaser is *unrelated* [422] to the seller". As Jarvis [423] correctly points out, the reference to *unrelated* purchasers and sellers is presumably an error. It is not clear why the relationship between unrelated purchasers and sellers should be regulated. [424] The intention was probably to refer to *related* parties. [425]

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[417] J A K Jarvis "Protection of Minority Shareholders - Section 228 of the Companies Act - Recommendation by the Standing Advisory Committee on Company Law" (June 1993) *De Rebus* at 482

[418] Of Companies Act 61 of 1973

[419] Of Companies Act 61 of 1973

[420] In terms of section 440A (1) of Act 61 of 1973

[421] Companies Act 61 of 1973

[422] My emphasis

[423] J A K Jarvis "Protection of Minority Shareholders - Section 228 of the Companies Act - Recommendation by the Standing Advisory Committee on Company Law" (June 1993) *De Rebus* at 482

[424] J A K Jarvis "Protection of Minority Shareholders - Section 228 of the Companies Act - Recommendation by the Standing Advisory Committee on Company Law" (June 1993) *De Rebus* at 482

[425] J A K Jarvis "Protection of Minority Shareholders - Section 228 of the Companies Act - Recommendation by the Standing Advisory Committee on Company Law" (June 1993) *De Rebus* at 482

The emphasis on the relationship between purchaser and seller (i.e. the selling company) is in any event misplaced. [426] The relationship between the controlling shareholders of the seller and the purchaser is of far greater significance. [427] The concept of "control", as envisaged by section 440A of the Companies Act [428] and in the Code, could also be used to measure the relationship between the purchaser and seller where the purchaser is a company. [429] However, the current concept of "control" does not lend itself to be utilised where the purchaser is not a company as there is no shareholding to measure control. [430] In these cases the existing concept of "control" needs to be expanded to beyond a specified shareholding. This could prove to be the source of some difficulty. [431] By way of illustration, Jarvis [432] uses the example of a partnership comprising 10 people with one of those partners being the controlling shareholder of the selling company. The question is then asked whether the acquisition by the partnership would fall within the definition of an "affected transaction" due to the fact that each partner has control of the partnership by virtue of the common law right of every partner to bind the partnership. [433] The reason why such a transaction would then be an "affected transaction" is that one person, the relevant partner, is the controller of both the selling company and the purchasing partnership.

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[426] J A K Jarvis "Protection of Minority Shareholders - Section 228 of the Companies Act - Recommendation by the Standing Advisory Committee on Company Law" (June 1993) *De Rebus* at 482

[427] J A K Jarvis "Protection of Minority Shareholders - Section 228 of the Companies Act - Recommendation by the Standing Advisory Committee on Company Law" (June 1993) *De Rebus* at 482

[428] Act 61 of 1973

[429] J A K Jarvis "Protection of Minority Shareholders - Section 228 of the Companies Act - Recommendation by the Standing Advisory Committee on Company Law" (June 1993) *De Rebus* at 482

[430] J A K Jarvis "Protection of Minority Shareholders - Section 228 of the Companies Act - Recommendation by the Standing Advisory Committee on Company Law" (June 1993) *De Rebus* at 482

[431] J A K Jarvis "Protection of Minority Shareholders - Section 228 of the Companies Act - Recommendation by the Standing Advisory Committee on Company Law" (June 1993) *De Rebus* at 482

[432] J A K Jarvis "Protection of Minority Shareholders - Section 228 of the Companies Act - Recommendation by the Standing Advisory Committee on Company Law" (June 1993) *De Rebus* at 482

[433] J A K Jarvis "Protection of Minority Shareholders - Section 228 of the Companies Act - Recommendation by the Standing Advisory Committee on Company Law" (June 1993) *De Rebus* at 482

Similar questions would arise in relation to close corporation purchasers. Unless the members have agreed otherwise in terms of an association agreement, section 54 of the Close Corporations Act [434] determines that all members of the close corporation have the power to bind the corporation. Again the question could be raised whether an acquisition by the close corporation would be termed an "affected transaction" if a member of the close corporation is also a controlling shareholder of the selling company. Again, one person is the controller of both the purchasing close corporation and the selling company.

Once the problem of determining whether a section 228 [435] disposal constitutes an "affected transaction" has been overcome, the next question that needs to be answered is what should be done once such a disposal has been classified as an "affected transaction". [436] The difficulty is namely that the Code provides for a remedy which makes it obligatory for the offeror to purchase the shares of shareholders in the offeree company other than those involved in the acquisition of control. [437] The problem is exacerbated by section 440C (2) of the Act [438] which makes it clear that the Panel has no jurisdiction to judge "the commercial advantages and disadvantages of an affected transaction". No commercial judgement is thus made by the Panel in regulating the extension of an equivalent offer to minority shareholders. [439]

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[434] Companies Act 69 of 1984
[435] Of Companies Act 61 of 1973
[436] J A K Jarvis "Protection of Minority Shareholders - Section 228 of the Companies Act - Recommendation by the Standing Advisory Committee on Company Law" (June 1993) *De Rebus* at 482
[437] General Principle 10 in section C of the Code and Rule 8 of the Code
[438] Companies Act 61 of 1973
[439] J A K Jarvis "Protection of Minority Shareholders - Section 228 of the Companies Act - Recommendation by the Standing Advisory Committee on Company Law" (June 1993) *De Rebus* at 482

Where a disposal of assets by a company becomes an "affected transaction", [440] however, what would be expected of the Code and Panel? Jarvis [441] asks the question whether rules are to be incorporated requiring the Panel to require the purchaser of the assets of the selling company to extend an offer to purchase shares in the selling company? He answers [442] that if this is the case, presumably the offer will be limited to those shareholders of the selling company who do not have control of the purchaser. And if this problem can be overcome, at what price will the offer for shares be made? The problem is namely that there is no existing offer to the majority shareholders that could simply be made applicable to the minority shareholders. No price has yet been established for the shares of the company and the Panel will have to fix a fair price to protect the interests of the minority shareholders. This will constitute a commercial judgement. [443]

Should the offeror, who has bought the company assets at fair value, be obliged to also offer to buy the shares of the minority, this would mean that he would probably pay more than the net asset value of the company. This, in turn, might be unfair towards the offeror unless this fact is discounted when establishing the price of the assets, a possibility fraught with difficulty.

It must be reiterated that the Panel is not empowered to judge the "commercial advantages and disadvantages" of a proposed transaction. [444]. Added to this lack of jurisdiction is the practical problem that the Panel does not have the necessary staff or qualified resources to carry out such a commercial judgement. This problem

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[440] As defined in section 440A (1) of Companies Act 61 of 1973

[441] J A K Jarvis "Protection of Minority Shareholders - Section 228 of the Companies Act - Recommendation by the Standing Advisory Committee on Company Law" (June 1993) *De Rebus* at 482

[442] J A K Jarvis "Protection of Minority Shareholders - Section 228 of the Companies Act - Recommendation by the Standing Advisory Committee on Company Law" (June 1993) *De Rebus* at 482

[443] J A K Jarvis "Protection of Minority Shareholders - Section 228 of the Companies Act - Recommendation by the Standing Advisory Committee on Company Law" (June 1993) *De Rebus* at 482

[444] In terms of section 440C (2) of the Companies Act 61 of 1973

could in theory be overcome by outsourcing this aspect to consultants. This would of necessity have cost implications and would also require an amendment to the current rules.

Even if the possible solution of outsourcing, with a concomitant amendment to the rules, is accepted, this would require the Panel to make economic judgements and thereby enter the economic arena. [445] This was never the intention in establishing the Panel. [446] The question therefore needs to be asked whether, as a matter of policy, the Panel should enter this arena.

In an article in the Financial Mail [447] it was pointed out that the inclusion of section 228 [448] disposals within the definition of an "affected transaction" would mean that the Securities Regulation Panel could become involved in making commercial judgements also about the price at which company assets are sold or purchased which is an area "dangerously akin to a regulatory minefield." [449]

It is submitted that the answer to this problem can be found in the judgement of Vermooten J in *Investors Mutual Funds Limited v Empisal (South Africa) Limited.* [450] In this case the minority shareholders of Empisal sought to interdict the holding of a meeting of the company where a resolution in terms of section 228 of the Companies Act, [451] authorising the sale of the company's assets, was to be passed by the majority of shareholders. [452] Relying on section 252, [453] the minority

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[445] J A K Jarvis "Protection of Minority Shareholders - Section 228 of the Companies Act - Recommendation by the Standing Advisory Committee on Company Law" (June 1993) *De Rebus* at 482
[446] J A K Jarvis "Protection of Minority Shareholders - Section 228 of the Companies Act - Recommendation by the Standing Advisory Committee on Company Law" (June 1993) *De Rebus* at 482
[447] "Melamet Commission : There is no Profit in Protection" (23 April 1993) *Financial Mail 29*
[448] Of Companies Act 61 of 1973
[449] "Melamet Commission : There is no Profit in Protection" (23 April 1993) *Financial Mail 29*
[450] 1979 (3) SA 170 (W)
[451] Companies Act 61 of 1973
[452] At 170
[453] Of Companies Act 61 of 1973

shareholders contended that the sale of the assets was unfairly prejudicial to them. The Court held [454] that section 252 [455] contained no provision empowering the Court to interfere with the ordinary running of the business of the company by its directors or controlling shareholders.

It was further held [456] that section 252 [457] related to something already done and not to something to be done in the future, but that, if a transaction was subsequently found to be unfairly prejudicial to the minority shareholders, the appropriate remedy would be for the Court to order the purchase of the shares of the minority either by the controlling shareholders or by the company at a price which may be fixed by the Court. In such event the minority shareholders could not be "locked in". [458] The objecting minority shareholders are therefore not obliged to accept the oppressive actions of the majority. [459] Section 252 [460] provides them with a remedy to counter the actions of the majority and, if necessary, to force the majority shareholders to buy the shares of the minority shareholders. [461] Thus, if unfair prejudice is proved, a similar result is reached as that contemplated by the Code in the case of a takeover and a subsequent offer to minority shareholders.

In the course of his judgement Vermooten J came to a number of important conclusions. The minority shareholders contended [462] that the transaction was unbusinesslike and that the effect of the transaction would be to convert Empisal from a trading concern to a company owning only cash, with a consequent reduction

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[454] At 177
[455] Of Companies Act 61 of 1973
[456] At 177
[457] Of Companies Act 61 of 1973
[458] At 177
[459] At 177
[460] Of Companies Act 61 of 1973
[461] At 177
[462] At 175

of profit, in which the objecting minority would be locked in. However, Vermooten J concluded [463] that the transaction was not unfairly prejudicial to the minority shareholders. The learned Judge stated [464] that they were not being treated any differently from the majority shareholders. There has therefore been no discrimination whatsoever between the majority and minority shareholders. [465] It must be stated, however, that the criteria for establishing unfair prejudice are not limited to whether the majority and minority shareholders were treated in the same way. Even though they may have been treated in the same way, the effect of the treatment could be discriminatory between the two classes of shareholders. This issue was not dealt with in the course of the judgement.

Vermooten J again stated [466] the fundamental principle of company law that majority rule prevails subject to certain exceptions. Such exceptions include the cases where a 75% majority is required as well as confirmation by the Court as in the case of a scheme of arrangement under section 311. [467] The principles stated in this judgement will be reverted to later.

Jarvis [468] suggests that protection of minorities should be sought by means other than bringing transactions requiring a section 228 [469] approval within the rules of the Code and under the supervision of the Panel. He favours the law as it stands since any oppressed shareholder has a right of recourse in terms of section 252 of the Act [470] which gives the Court extremely wide powers in circumstances where there is

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[463] At 175
[464] At 175
[465] At 175
[466] At 175
[467] Of Companies Act 61 of 1973
[468] J A K Jarvis "Protection of Minority Shareholders - Section 228 of the Companies Act - Recommendation by the Standing Advisory Committee on Company Law" (June 1993) *De Rebus* at 482
[469] Of Companies Act 61 of 1973
[470] Companies Act 61 of 1973

oppression or unfairness to any one or more shareholders. [471] He finds it difficult to understand why greater protection should be given to a minority shareholder than for example a land owner who feels that his rights have been infringed by his neighbour. [472] Such a land owner is obliged to seek the protection of the Court to ensure his rights. Similar considerations surely apply to minority shareholders according to Jarvis. [473]

However, although there is some merit in Jarvis' contentions, there should be neutrality of treatment of minority shareholders irrespective of the method of takeover employed. The question should therefore be posed whether minority shareholders in an asset takeover, as opposed to a takeover regulated by the Securities Regulation Code, are treated equally. This question must surely be answered in the negative. As was clearly illustrated in the *Micor* and *Racy* cases, majority shareholders can expropriate minorities by way of the section 228 [474] procedure with impunity. Although this possibility also exists in the case of an "affected transaction", far better safeguards are in place to ensure fair treatment of minority shareholders. In the case of the section 228 [475] procedure there are very few procedural requirements which the majority shareholders need to adhere to. All that is required is a resolution as provided by section 228 of the Act. [476] On the opposite side of the scale, "affected transactions" are extensively regulated in terms of the Code. These provisions are also policed by the Panel to ensure fair treatment

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[471] J A K Jarvis "Protection of Minority Shareholders - Section 228 of the Companies Act - Recommendation by the Standing Advisory Committee on Company Law" (June 1993) *De Rebus* at 482

[472] J A K Jarvis "Protection of Minority Shareholders - Section 228 of the Companies Act - Recommendation by the Standing Advisory Committee on Company Law" (June 1993) *De Rebus* at 482 - 483

[473] J A K Jarvis "Protection of Minority Shareholders - Section 228 of the Companies Act - Recommendation by the Standing Advisory Committee on Company Law" (June 1993) *De Rebus* at 482 - 483

[474] Of Companies Act 61 of 1973

[475] Of Companies Act 61 of 1973

[476] Companies Act 61 of 1973

of minority shareholders in accordance with the general principles and rules of the Code. Unlike the position under section 228, [477] in the case of minority protection afforded by the Code this protection is provided to minority shareholders *ipso facto* and no action is required from such minority shareholders.

[477] Of the Companies Act 61 of 1973

5. CONCLUSION

It was earlier stated that, on policy grounds, it is undesirable that different levels of minority shareholder protection are applicable depending on the method chosen to effect a takeover. For many years the *de facto* position in South Africa has been that the level of protection afforded to minority shareholders depended on the chosen method of the offeror in a takeover. The criticism against this position has not gone unheard and the Legislature has gone some way to addressing this problem. By including Rule 29 in the Code, greater neutrality has been achieved in the treatment of minority shareholders. Utilising the scheme of arrangement, reduction of capital or conversion of securities procedures no longer exempts the offeror from complying with the substantive takeover provisions, i.e. the Securities Regulation Code on Take-overs and Mergers. If the takeover involves the "securities" of the offeree company, the offeror needs to comply with the Code.

This inclusion of the other methods within the ambit of the Code does not mean that complete neutrality of treatment of minority shareholders has been achieved. A scheme of arrangement, reduction of capital or conversion of securities only requires the approval of 75% of the members of such company to be implemented. Such a scheme, reduction or conversion will then be binding on the minority. They could therefore be expropriated by a 75% majority. On the other hand, a takeover effected by a normal takeover offer is treated differently. In terms of section 440K (1) (a) of the Companies Act [478] the offeror in an "affected transaction" may only acquire the shares of a dissenting minority if 90% of the members in the offeree company have

[478] Companies Act 61 of 1973

accepted his offer. Thus the expropriation of minority shareholders can only take place if a 90% majority is achieved. Although Rule 29 of the Code provides for the possible exclusion of majority votes, this is not guaranteed and will not be done in all cases.

The difference in treatment of minority shareholders depending on the method of takeover is also still prevalent in those instances where the Code is not applicable e.g. where the offeree company is a private company with a shareholding of less than R5 million or where there are less than 10 shareholders. It must, therefore, be concluded that total neutrality of treatment has not yet been achieved.

It is, however, submitted that the solution to this problem is not in prohibiting takeovers by means of the scheme of arrangement, reduction of capital or conversion of securities methods. It must be agreed with Goldstone AJ [479] that these schemes play an important role in commercial life. One needs to be pragmatic and recognise the fact that it would be unwise to completely prohibit these procedures as methods to achieve takeovers. It is suggested that this lack of neutrality could rather be addressed as follows :

- The inclusion of a provision within the Code and/or the Companies Act [480] providing that if a scheme of arrangement, reduction of capital or conversion of securities is used to effect or results in a takeover, the required resolution approving such a scheme, reduction or conversion must be approved by a 90% majority of shareholders or class of shareholders rather than the normal 75%. [481]

[479] In *Namex (Edms) Bpk v Kommissaris van Binnelandse Inkomste* 1994 (2) SA 265 (A) at 294
[480] Companies Act 61 of 1973
[481] Unlike the position in terms of Rule 29 of the Code, this increase in the required majority will be effective in all cases and will not be left to the discretion of the Panel.

- A prohibition in the Companies Act [482] against utilising the reduction of capital or conversion of securities procedure to effect a takeover unless the Code will be applicable to such a transaction.
- It is submitted that the scheme of arrangement procedure should remain available as a method of takeover even if the Code is not applicable to the transaction. Sound commercial reasons exist for utilising this method to take over a company in financial difficulty. Although the same level of protection is not available as that afforded by the Code, it is submitted that section 311 of the Companies Act [483] provides sufficient protection to minority shareholders. Where the Code is not applicable, it is suggested that a normal special resolution would suffice and the 90% requirement should not be applicable in these instances.

Where the Code applies to a transaction these suggested amendments will ensure that a minority can not be expropriated by a smaller majority depending on the method chosen to effect a takeover. Where the Code is not applicable to a takeover, it is suggested that these other methods, except for the scheme of arrangement, should not be available to effect a takeover due to the insufficient minority shareholder protection in these instances. Where the scheme of arrangement procedure is used to effect a takeover, it is proposed that the requirements of section 311 [484] be interpreted restrictively. The scheme should not be sanctioned by the Court if the takeover can conveniently be implemented by a normal takeover offer. In this regard the approach adopted in *Ex Parte Mielie-Kip* [485] is endorsed.

[482] Companies Act 61 of 1973
[483] Companies Act of 61 of 1973
[484] Of Companies Act 61 of 1973
[485] 1991 (3) SA 449 (W)

Although it is not satisfactory that minority shareholders could be treated differently in the case of an asset takeover, it is submitted that the inclusion of section 228 [486] disposals within the definition of "affected transaction" is not the solution. The conceptual problems inherent in such an inclusion negate this possibility. On the other hand, it is submitted, the present situation needs to be addressed. In this regard Jarvis [487] makes certain recommendations regarding possible amendments to section 228. [488] It is submitted that better protection to these minority shareholders would be afforded by an amended section 228, [489] along the lines as suggested by Jarvis, [490] which would provide for the following:

(i) The incorporation of a requirement that a "fair and reasonable" statement by an independent third party with suitable qualifications be provided pertaining to the offer (in particular whether the price offered for the assets is fair and reasonable) where there is a relationship, as defined in the Companies Act, [491] between the purchaser and the controller of the selling company; and

(ii) the resolution in support of a transaction envisaged in section 228 [492] should require the support of a defined majority [493] of all minority shareholders [494] in those circumstances where there is a relationship, as defined, between the purchaser and the controller of the selling company.

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[486] Of Companies Act 61 of 1973
[487] J A K Jarvis "Protection of Minority Shareholders - Section 228 of the Companies Act - Recommendation by the Standing Advisory Committee on Company Law" (June 1993) *De Rebus* at 483
[488] Of Companies Act 61 of 1973
[489] Of Companies Act 61 of 1973
[490] J A K Jarvis "Protection of Minority Shareholders - Section 228 of the Companies Act - Recommendation by the Standing Advisory Committee on Company Law" (June 1993) *De Rebus* at 483
[491] Companies Act 61 of 1973
[492] Of Companies Act 61 of 1973
[493] Preferably a simple majority of all minority shareholders should suffice.
[494] Those shareholders who do not hold a controlling interest, as defined in the Companies Act 61 of 1973, in the company.

As Jarvis [495] correctly points out, this proposed solution will only have the effect of reducing the number of potentially unhappy minority shareholders. It is, however, suggested that such an amendment would go some way to addressing the current deficiencies in the law. On policy grounds it is felt that a deviation from majority rule, which rule was expounded by Vermooten J, is justified under the stated circumstances where a relationship exists between the purchaser and the controller of the selling company. The required relationship between purchaser and controller of the selling company must be defined in the Companies Act [496] and must include instances where the purchaser and the controller of the selling company is the same person or they are acting in concert or where the controller of the selling company also has a controlling interest in the purchaser. Such deviation is essential to ensure greater neutrality of treatment of minority shareholders, irrespective of the method employed to effect a takeover. However, the time has not yet arrived for the inclusion of these transactions within the ambit of the Securities Regulation Code. The stated conceptual problems and a lack of resources negate such an inclusion at this point in the development of our securities legislation. The desirability for such inclusion in the future is not doubted.

[495] J A K Jarvis "Protection of Minority Shareholders - Section 228 of the Companies Act - Recommendation by the Standing Advisory Committee on Company Law" (June 1993) *De Rebus* at 483

[496] Companies Act 61 of 1973

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