

B997431
93030159

**MANAGEMENT BUY-OUTS
AND DIRECTORS' FIDUCIARY DUTIES**

by

Leon George Raubenheimer

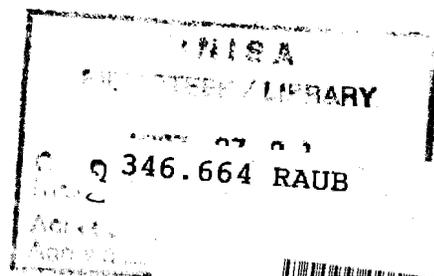
Submitted in partial fulfilment
of the requirements for a degree
of
MASTER OF LAWS
at the
UNIVERSITY OF SOUTH AFRICA

SUPERVISOR: PROF J T PRETORIUS

November 1992

ACKNOWLEDGEMENTS

I wish to acknowledge the assistance of the following persons for their help in preparing this dissertation. To Sue Farenden for her endless support, to Joan Besseling for the typing, the staff of the Unisa library for the assistance they provided, and to Professor J T Pretorius for his invaluable comments and insight.



CONTENTS

1. Introduction
2. Management Buy-Outs Explained
 - 2.1. Introduction
 - 2.2. History of Management Buy-Outs
 - 2.2.1 United States
 - 2.2.2 United Kingdom
 - 2.2.3 South Africa
 - 2.3 The Making of a Management Buy-Out
 - 2.3.1 The Candidates
 - 2.3.2 Criteria for Success
 - 2.3.2.1 Management Criteria
 - 2.3.2.2 Financial and Business Criteria
 - 2.3.3 Structuring and Financing a Management Buy-Out
 - 2.3.3.1. Structure
 - 2.3.3.2. Financing
 - 2.3.4 Exiting from the buy-out

3. Criticisms of Management Buy-Outs
 - 3.1 Introduction
 - 3.2 Breach of Fiduciary Duties
 - 3.2.1 Introduction
 - 3.2.2 Conflicts of Interest ✓
 - 3.2.2.1 Introduction
 - 3.2.2.2 Fair Price
 - 3.2.2.3 Self Interest and Secret Profits
 - 3.3 Insider Trading
4. The Arguments in Favour of Management Buy-Outs
 - 4.1 Introduction
 - 4.2 Fair Price
 - 4.2.1. Disclosure
 - 4.2.2 Fair Price determinations
 - 4.3 Self Interest and Secret Profits
 - 4.4 Insider Trading
5. Conclusions and Recommendations
6. Bibliography
 - 6.1 Recommended books
 - 6.2 Articles
 - 6.3 Cases
 - 6.4 Legislation

S U M M A R Y

Management Buy-Outs occur when the managers of a company buy the company from its owners, namely the shareholders. Where such a company is a listed public company, the transaction is known as "going private." The critics allege that this type of buy-out leads to irreconcilable conflicts of interests, a breach of fiduciary duties and to insider trading by the directors. For this reason Management Buy-Outs should be prohibited or alternatively, regulated to such an extent as to make them virtually unworkable.

It is submitted that these conflicts are not irreconcilable and that they are no different to the myriad of other conflicts which arise out of the promotion, incorporation and the operation of a company. Both statute and the common law effectively deal with most of the critics' apprehensions without necessarily prohibiting the transactions giving rise to them.

1. INTRODUCTION

A Management Buy-Out is a process whereby a management consortium¹ buys the existing shareholders' shares in a company. The shareholders may be public shareholders in a listed company (this buy-out process is known as "going private"²) or any number of shareholders in an unlisted entity. While Management Buy-Outs have changed a great deal in recent years, basic conflicts of interest arising during the buy-out process still remain, particularly during "going private" transactions. There are three major problem areas which must be addressed. The first occurring when the assets are purchased, the second occurring when either the assets or the shares are purchased and the third when the shares and, to a limited extent, the assets are purchased.

First, the members of the management team have an inevitable conflict of interest when it is considered that when they buy the assets of the company, they must serve effectively as fiduciaries on behalf of the selling company and at the same time negotiate on their own behalf as buyers. Such a conflict arises as a result of the management being duty bound to obtain the best possible price for the assets on the one hand and as purchasers, wanting the lowest possible price in order to service the enormously high

¹ The buy-out team may include both director and non-director managers. In South Africa there is now a trend, as in Canada, to subject "top management" to the same fiduciary duties as a director. (See Sibex Construction(SA)(Pty)Ltd v Injectaseal CC 1988 (2) SA 54(T) at 67 and Canadian Aero Services Ltd v O'Malley (1974) 40 DLR (3d) 371 (SCC).

² Going private can be defined as de-listing under the Listing Requirements of the Johannesburg Stock Exchange once the company no longer complies with section 5.6 contained in section I or where an application has been made for a de-listing in terms of rule 10 in section II of the Listings Requirements.

debt levels, on the other³.

Secondly, the directors may identify, prior to the buy-out, regardless of the structure used, certain assets of the company which if re-deployed or sold, could add substantial value to the company, but only implement such strategies after the buy-out transaction is completed⁴.

Lastly, the managers are the ultimate insiders as they are proxy to information not generally made available to the shareholders, thereby giving them an unfair advantage when buying the company⁵.

A major critic of Management Buy-Outs, Benjamin Stein, argues that these conflicts are irreconcilable, particularly in the case of a listed company going private and that buy-outs should either be prohibited or heavily regulated. He calls buy-outs an ongoing national disgrace and that "drastic federal action is needed, right now before investors are further abused and demoralized"⁶.

The purpose of this contribution is first, to discuss the various elements making up a Management Buy-Out in chapter 2; secondly, to analyse the problems referred to by the critics in chapter 3; thirdly, debating whether these conflicts are in fact irreconcilable and whether buy-outs should be prohibited or at least heavily regulated as suggested by the critics in chapter 4; and lastly, to place the various problems specific to buy-outs into perspective and make certain recommendations in chapter 5.

³ B J Stein 'Dear Mr Ruder Your View of Management MBO's is Simply Dead Wrong' (1989) Barrons 44.

⁴ A Lipper 'LBO's Based on Insider Information' (1987) Venture 7.

⁵ Ibid. This can be the case whether the shares or the assets are purchased.

⁶ Stein op cit note 3 at 44.

Much of the material referred to, relates to the problems experienced in the United States and to some extent in the United Kingdom as regards Management Buy-Outs, however, the solutions to the problems that arise and arguments in favour of buy-outs have been analysed against the backdrop of the prevailing South African common law and statutory and regulatory provisions.

2. MANAGEMENT BUY-OUTS EXPLAINED

2.1. Introduction

A Management Buy-Out can be loosely defined as the purchase of a substantial shareholding in a company by a small team of managers with an entrepreneurial outlook and a strong desire for management independence⁷. According to David Clutterbuck and Marion Devine in their book Management Buyouts⁸ there are four basic motives for participating in a buy-out, namely; Desperation (this may be due to changing markets and a change in the focus of the company leading to decreasing job security and satisfaction); Ambition (the manager is tired of the corporate environment and wants to work for himself); Frustration (the manager is being held back by staid, inefficient and inflexible owners); and Opportunism (an opportunity arises to purchase the company and the managers take advantage of it). Regardless of the reasons for participating in a buy-out, it offers the capable management team a rare business opportunity to acquire control of a business they previously only managed (in some cases they may have had substantial equity stakes, but not real and effective control)⁹. It also offers them the chance of making a fortune once the debt is repaid and the

⁷ Management Buy-Outs' (1986) Finance Week Survey 4.

⁸ D Clutterbuck and M Devine Management Buyouts (1987) 59. See also S Green 'The Incentive Effects of Ownership and Control in Management Buy-Outs' (1988) 21 Long Range Planning 26;

⁹ G White 'The Making of an MBO' (1986) 98 Accountancy 95

company is either re-sold or listed on the Stock Exchange.

The buy-out is usually executed by using large amounts of debt and very little equity¹⁰ (sometimes referred to as a Leveraged Buy-Out (LBO) because of the high gearing involved¹¹). In order to gear up to the levels necessary to make the purchase with very little of their own equity, the managers have to rely on first, the assets of the company to secure the finance and second, its cash flow to service and repay the debt.

2.2 History of management buy-outs

2.2.1 United States

Management Buy-Outs in the United States had its origins in the so called "bootstrapping" deals of the 1960's, when a number of troubled, privately held companies were put back on their feet by innovative financiers who raised funds using a company's cash flow as well as its assets¹². As diversification, once regarded as a panacea for cyclical slumps, became to be regarded with scepticism in the early 1980s, more and more conglomerates wished to rid themselves of peripheral and non-performing assets. As a result, Management Buy-Outs became prevalent as an accepted method of achieving this end. Undervalued and underperforming companies were sold off to management who were transfixed by the idea of

¹⁰ See paragraph 2.3.3.2 for a detailed explanation on the financial structuring of a buy-out.

¹¹ Gearing and Leverage are financial terms referring to the amount of debt an individual or a company acquires. For example, if a company has a great deal of debt relative to its equity, it is said to be highly geared or highly leveraged.

¹² C Ruffel 'Funds Galore for LBO Prospects' (1986) Euromoney-Special Survey: The Lucrative World of Management Buyouts 3.

equity stakes and shared profits and heartened by the availability of capital¹³.

The buy-out market has grown exponentially since then, not only in the number of deals being effected but also in the incredible size of the buy-outs. The total annual dollar volume for Management Buy-Outs in the United States rose from less than \$1 billion in 1980 to \$11 billion in 1984 to some \$43 billion in 1988¹⁴. This was mainly due to the development of the junk bond market¹⁵ in the United States, which enabled managers to raise enormous amounts of money, for example, the RJR Nabisco buy-out team raised approximately \$19 billion using junk bonds¹⁶ in order to effect the buy-out.

2.2.2 United Kingdom

Management Buy-Outs have become a major part of the United Kingdom's business and commercial landscape. As times have got tougher corporate managements have been looking harder at their portfolios of operating

¹³ R Brooke 'Management Buy-Outs Give Industry a New Lease of Life' (1984) Industrial Management & Data Systems 6; see also S Birley 'Success and Failure in Management Buyouts' (1984) 17 Long Range Planning 32.

¹⁴ L Lowenstein 'No More Cosy Buy-Outs' (1986) 64 Harvard Business Review 149.

¹⁵ "Junk bonds" are nothing more than high interest rate loans or debentures which are generally not adequately secured by any assets or other form of security. There is in fact no real difference between junk bonds and unsecured debentures which are an established feature on the South African commercial scene as a means of raising finance. For further information regarding "junk bonds", see: S Solinga 'LBO's, Junk Bonds and new Tax Laws' The Best of Buyouts (1982-1987) 171-175, R Pozdena 'Takeovers and Junk Bonds' The Best of Buyouts (1982-1987) 239, B D Fromson 'The Last Days of Drexel Burnam' (21 May 1990) Fortune 90 and G Yago Junk Bonds: How High Yield Securities Restructured America (1991) .

¹⁶ H Randhawa 'PIK: A Way to Relieve LBO Concerns' (1990) 15 Accountancy 100. It must be noted that if too large a debt burden is taken on by the management or for that matter the company, the greater the danger of failure as any company can be ruined if too much is paid for it. (See J Whistler 'Avoiding the Pitfalls' The European Buy-Out Directory 1992 183.)

companies. The companies which are underperforming or no longer fit the parent's core business are simply sold off¹⁷. For this reason, the divestment of divisions and subsidiaries by domestically owned parent firms has become the principal source of buy-outs in the United Kingdom (some 60 - 80% of all buy-outs)¹⁸. The number of Buy-Outs of all sizes rose from about 100 in 1980 to 340 in 1988, falling to 270 in 1989. In terms of amount, the United Kingdom's total grew from £300 million in 1984 to £6.4 billion in 1989¹⁹. It is submitted that in the light of the above statistics the buy-out market should continue to show growth in the future.

2.2.3 South Africa

In the past South Africa's main source of buy-outs had been the flurry of divestments in the mid-1980's by multi-national corporations, mainly due to the political pressure abroad. However, this source has now all but dried up after the sweeping political changes in South Africa. The main source of buy-outs now flows from a variety of corporate restructurings like Tongaat-Hulett selling off its transport arm Hultrans²⁰.

The total value of the South African buy-out market is approximately R300 million per annum, which is relatively small compared to the United States and United Kingdom markets²¹.

¹⁷ R Upton 'Britains Buy-Out Boom' (1984) 16 Personnel Management 22.

¹⁸ D C Gardner D C Gardner Workbook - Leverage and Management Buy-Outs (1990) 5.

¹⁹ Ibid. at 5

²⁰ A Roux 'The Buy-Out Scene in South Africa' Management Buyouts, Leveraged Acquisitions and the Financial Entrepreneur 3 August 1989 FKV Conference Transcripts 3.

²¹ This information was obtained from interviews conducted by the writer with André Roux, Vice President - Equity and Leveraged Capital Division of FirstCorp Merchant Bank Limited, for the purposes of completing this work. See also K Clarke 'Managing the Deal' The Finance Week 200 Supplement (19-25 March 1992) 220

2.3. The making of a Management Buy-Out

2.3.1. Circumstances where buy-outs may occur

There are a number of circumstances which lend themselves to the possibility of a buy-out:

- 2.3.1.1 A parent company in financial difficulties may find it necessary to sell off profitable subsidiaries or divisions in order to raise cash. This often happens when a recession has caused a shortage of cash which has forced a company to sell parts of itself to its managers²².
- 2.3.1.2 When a subsidiary is unable to meet group objectives and its activities have become peripheral to the mainstream business of the parent company. This usually occurs after a reassessment of a company's previous strategy of diversification and has now decided to concentrate on its core businesses²³.
- 2.3.1.3 The members of a private company may decide to retire or merely wish to sell. The majority shareholder may prefer to sell to a loyal management team, in the belief that the company will not be broken up but continue to retain its independence and continue to offer employment to its workforce²⁴.

for more information regarding buy-outs in South Africa.

²² Anonymous 'Management buy-outs: Owner Occupiers' (1982) 285 The Economist 80.

²³ S Birley 'Success and Failure in Management Buyouts' (1984) 17 Long Range Planning 32.

²⁴ G White 'The Making of an MBO' (1986) 98 Accountancy 95.

2.3.1.4 A foreign holding company may divest itself of its interest in a country, following economic or political upheaval²⁵.

2.3.1.5 The management of a listed company may wish to take a publicly owned company "private"²⁶.

2.3.2 Criteria for success

2.3.2.1. Management criteria

The most important criteria for success of any buy-out is that of a well motivated and able management team, as without it, the pressures of running the company and the financial risk could become too much for the team²⁷. It is also essential for the management team to be well balanced and cover the whole range of management tasks, including sales, marketing, production and finance²⁸.

Senior management will almost always comprise a component of the buy-out team. This is even more important when one considers that one of the main conceptual foundations of the buy-out business is that managers who own their companies, work harder and more productively than those who are corporate employees²⁹. Most financiers agree that the most

²⁵ D Clutterbuck and M Devine Management Buyouts (1987) 5.

²⁶ R J Maupin and W A Label 'Profiting from a Management Buyout' (1987) 68 Management Accounting 32.

²⁷ M Wright and J Coyne Management Buy-Outs (1986) 83.

²⁸ Clutterbuck op cit note 25 at 23.

²⁹ L Hecht 'Managers who Succeed as Bosses'(1986) Euromoney-Special Survey: The Lucrative World of Management Buyouts 38. See note 8 for further references dealing with this topic.

important intangible element in a buy-out deal is the quality of the management team. There is a considerable reluctance to support buy-outs by independent investors, unless some of the principal managers agree to remain with and have an interest in the buy-out company³⁰.

2.3.2.2 Financial and business criteria

The ideal candidate for a buy-out from both the vendor and purchaser perspective is a company that is profitable without any major business or management problems³¹. It is submitted that if the buy-out is to succeed the company must be economically viable. This means it must be profitably managed, growing, relatively debt free, with a well established record. Financiers are not interested in deals which are based on management's expectations of turning the business around, cutting costs or re-organising production facilities³².

Considering the excessive optimism and enthusiasm which so often dominate buy-outs, the management team could easily delude both themselves and their financial backers as to the prospects and capabilities of the management and the company³³. Should this happen the financiers will have no certainty that the company is capable of generating sufficient cash flows to service³⁴ the debt on schedule³⁵.

³⁰ 'Management Buy-Outs' (1986) Finance Week Survey 4.

³¹ D Thompson 'Buy-Outs and Buy-Ins: Europe's 1992 shows the big way for free trade' (1989) 53 Business Quarterly 45.

³² 'Management Buy-outs' (1986) Finance Week Survey 5.

³³ Clutterbuck op cit note 25 at 36.

³⁴ The servicing of a debt means the timeous payment of the interest charge and the repayment of the capital instalments as per the financiers' terms.

Financiers also look at companies that hold a strong position in their market. A strong market share is generally associated with strong cash flows³⁶. These revenues must be immune to sudden reverses, changes in the market, intense competition and other pressures such as technological change³⁷. It is submitted that a stable cash flow is vital as it both services and repays the debt.

2.3.3 Structuring and Financing Management Buy-Out

There is an infinite number of ways to structure and finance a Management Buy-Out transaction and no 'generic structure' will apply perfectly to any one transaction. The eventual structure will depend on various factors. These include the objectives of buyer, seller, lenders, investors and management, the purchase price, assets, cash flow, operating characteristics of the purchased business, and the relative bargaining positions and skills of the parties involved³⁸. An attempt will therefore be made to explain only the most basic of principles involved.

2.3.3.1 Structure

Although some of the buy-out structures are exceptionally complex and intricate³⁹ the basic thread running through these

³⁵ J Ormerod and I Burns Raising Venture Capital in the UK (1988) 56.

³⁶ Finance Week op cit note 30 at 5.

³⁷ A Seymore and J Maguire 'Leverage: The Opportunities for Industry' (1986) Euromoney Survey 32.

³⁸ G H Koven and C Rafferty 'Structuring and Financing an LBO: A Conceptual Approach' Buyouts: Directory of Financing Sources 5ed (1989) 27.

³⁹ See C Ruffel 'Funds Galore for LBO prospects' (1986) Euromoney-Special Survey: The Lucrative world of Management Buy-Outs 3 for a detailed examination of the \$355 million buy-out of Houdille Industries in the United States in 1979. This buy-out is considered extremely complex even by today's standards.

buy-out structures is simple, either the buy-out team purchases the company's shares or alternatively it purchases the assets of the company.

a) **Purchasing the shares**

When the buy-out team decides to purchase the shares of the company, rather than the assets, they will acquire a total package of rights and obligations, assets and liabilities⁴⁰. Due to the unique method of financing a buy-out, that is using assets and cash flows of the company to service the debt, the potential of breaching capital maintenance provisions becomes pre-eminent⁴¹ when purchasing the shares.

In South Africa, for example, the provisions of section 38 deals with this issue⁴². A buy-out team would, therefore, not be

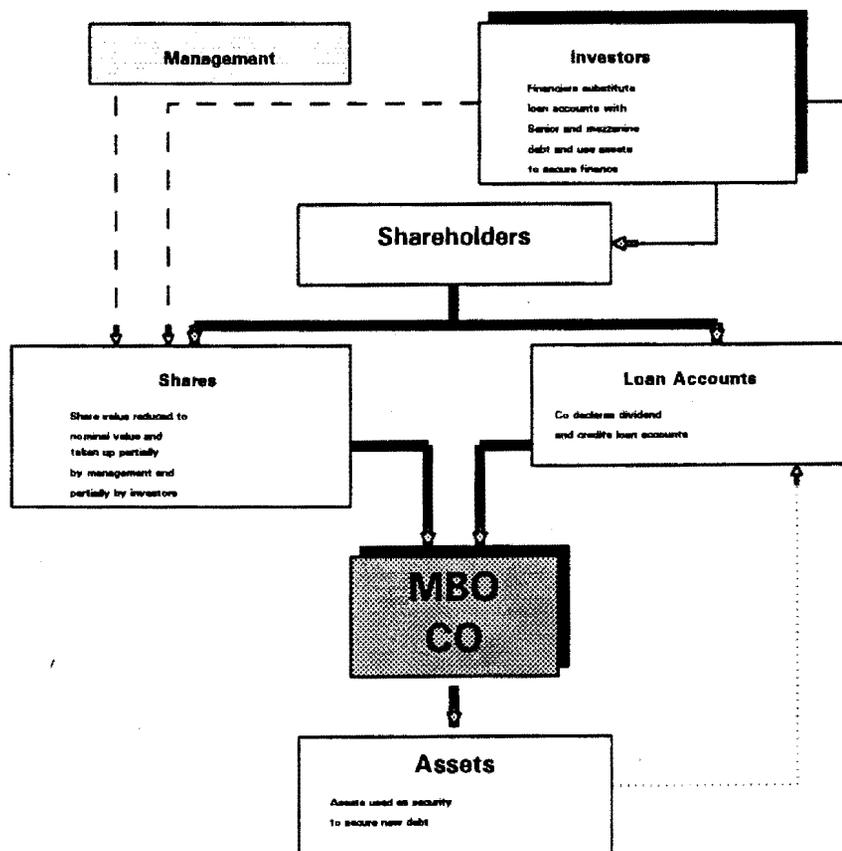
⁴⁰ I Krieger Management Buy-outs (1990) 130.

⁴¹ M Katz 'How to optimise the tax, accounting and legal issues in a Management Buyout' Management Buyouts, Leveraged Acquisitions and the Financial Entrepreneur 3 August 1989 FKV Conference 50

⁴² Section 38 of the Companies Act (No.61 of 1973), as amended, provides that a company is prohibited from giving, whether directly or indirectly and whether by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of or in connection with a purchase or subscription made or to be made by any person of or for the shares of the company. In the United Kingdom, section 151 of the Companies Act 1985 provides for the same prohibition, however, in the United States the assistance by a company to purchase its shares is permitted by common law. (See footnote 55 of L C B Gower Gower's Principles of Company Law 4ed (1979) 225 for reference to the position in the United States and 225-236 of his work for the position in the United Kingdom.). For further discussions on the prohibition in South Africa see J P G Lessing 'Maintenance of Share Capital' (1991) 4 The Law of South Africa 71 - 85 for an excellent overview of the principles involved in the interpretation of section 38. See also M Larkin 'Financial Assistance for the Acquisition of Shares' (1981) 11 Businessmans Law 5; H S Cilliers and M L Benade Company Law 4ed (1982) 383-391; M G Fredman 'Financial Assistance after Lipschitz' (1983) 12 Businessmans Law 138; M G Fredman 'Financial Assistance II' (1983) 12 Businessmans Law 183; M G Fredman 'Financial Assistance III' (1983) 13 Businessmans Law 25; M G Fredman 'Financial Assistance IV' (1983) 13 Businessmans Law 50; Anonymous 'S 38 Financial Assistance-The AD Judgement in the UDC Case' (1979) SACLU F-1 to F-17; and

permitted to use the company's assets as security to purchase the shares of the company. This often leads the team to devise complicated, yet legal, structures to achieve the same effect. Due to the complexity of effecting these structures, the financiers would generally prefer not to use this method unless the target or buy-out company has a substantial assessed loss or has a non-transferable trade mark or patent which would necessitate keeping the company intact and thereby offset the disadvantages of this structure. (See Diagram 1 along with the narrative which sets out the basic structure should the management team opt to purchase the shares of the target company).

Diagram 1



Narrative

This structure is most effective when the buy-out company is thinly capitalised⁴³ and has large shareholders loans. Where the shareholders loans are not very large but the company has large distributable reserves, the company may declare dividends to its shareholders and, instead of paying the dividend⁴⁴, credits their loan accounts. The management would then purchase the loan accounts and use the company's assets to to secure the loans.

Although this would at first blush appear to contravene the provisions of section 38, this practice was expressly permitted in Lipschitz v UDC Bank⁴⁵. The court could find no objection to the substitution of the loan accounts with other debt as the statute specifically prohibits assistance being given to purchase the shares and is silent as regards loan accounts. In order not to fall foul with the prohibition, the balance of the purchase price, namely, the nominal value of the shares remaining after the dividends had been credited to the loan accounts, would have to be financed by way of unsecured debt, usually preference shares or convertible debentures.

⁴³ When a company is thinly capitalised it means that there are relatively few shares issued and those that have been issued are of a low nominal value.

⁴⁴ In Novick v Comair Holdings Limited 1979 (2) 116 (W), it was held that a company may declare a dividend out of undistributed profit and credit the loan accounts of the shareholders acquiring the company. It is submitted that if this is the case, there can be no objection to the company crediting existing shareholders' loan accounts instead of paying a dividend, thereafter allowing the management to substitute the loan accounts with secured bank loans and using it to pay the shareholders.

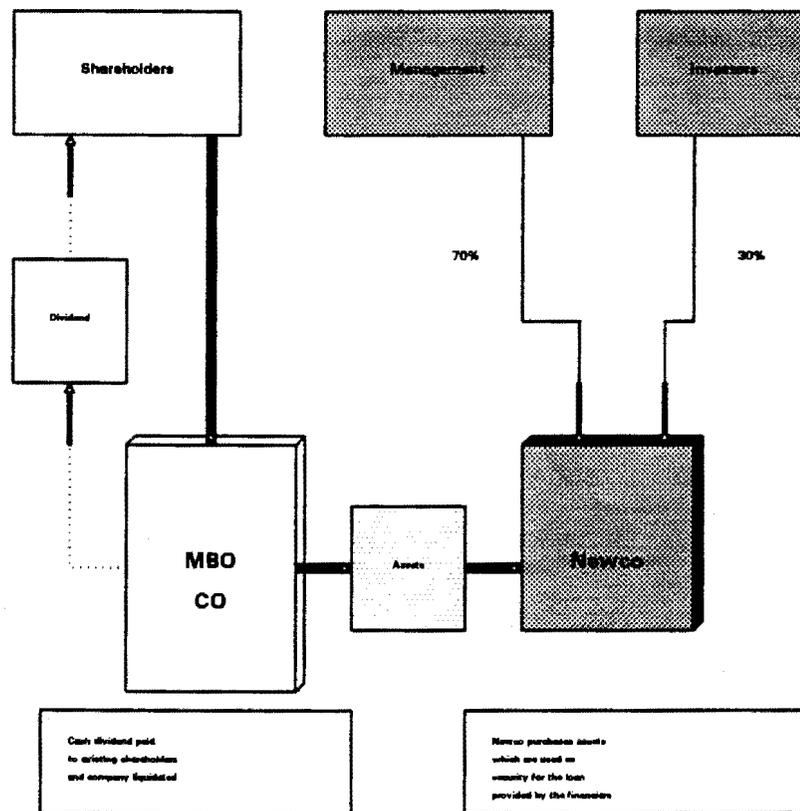
⁴⁵ 1979 (1) SA 789 (A). See also the following line of cases: Gradwell v Rostra Printers 1959 (4) SA 419 (A); Evrard v Ross 1977 2 SA 311 (D); Zentland Holdings (Pty) Ltd v Saambou Nasionale Bouvereening 1979 (4) SA 574 (C).

b) **Purchasing the assets**

When a buy-out team purchases the assets of a company it will be in a position to select the rights and assets they require and leave behind the obligations and liabilities which they do not⁴⁶. This method is most often used in jurisdictions which have capital maintenance requirements. The buy-out is effected by selling all or some of the assets of the existing company to an existing company or to a new entity⁴⁷.

(Diagram 2 and the narrative below sets out the process)

Diagram 2



⁴⁶ I Krieger Management Buy-outs (1990) 130.

⁴⁷ 'Management Buy-outs' (1986) Finance Week Survey 8.

Narrative to Diagram 2

The buy-out team would have to incorporate a new company (Newco) and use it as a vehicle to acquire the assets from the target buy-out company. After the sale, the buy-out company's only asset would be cash, and is commonly known as a cash shell. The cash would then be distributed to the cash shell's shareholders (once all liabilities have been settled) by way of a dividend or where the distributable reserves have been exhausted, by way of a reduction of capital⁴⁸. The financiers would provide finance to Newco in order to make the purchase. They would in this case, however, be in a position to secure their exposure by using the assets purchased by Newco as security by way of a mortgage or notarial bond⁴⁹ without

⁴⁸ The reduction of capital would be effected in terms section 83 (if no creditors exist) or section 84 (if there are creditors the sanction of the court is required) of the Companies Act (No.61 of 1973), as amended.

⁴⁹ There are a number of bonds which can be used to secure the assets of a company. First, where immovable property is involved, a mortgage bond is usually passed over property which is generally the most secure form of security. In order to secure movables the process becomes somewhat more complex. A notarial bond is usually passed over the movable assets which can be either be a covering bond or a Natal Bond (this depends on the location of the company and must comply with the provisions of the Notarial Bonds (Natal) Act 18 of 1932). A covering bond may either be general or special, but can only be used before the debt arises. See the recent Appellate Division case of Brian St Clair Cooper N.O. and others v The Master of the Supreme Court (QFS) and another 1992 (3) 60 (A) which has seriously effected the security of a special notarial bondholder, mortgaging specified movable assets, in the event of a liquidation. The court held that unless the mortgagee is in possession of the assets on insolvency of the mortgagor, the bond does not confer any preference in respect of the bondholders claim against the mortgagor.

This latest case does not effect a Natal Bond which has far greater legal effect. Movables in that province, which have been specially hypothecated by notarial bond are, subject to a landlords hypothec, deemed to have been pledged to the holder of the bond in the same manner as if they had been delivered to him as a pledge. The goods and other movables must be specifically described and enumerated, so that they may be identified in a moment. (See J F Coaker and D T Zeffertt Wille and Millin Mercantile Law of South Africa 18ed (1984) 374-413 for a comprehensive discussion on bonds.)

contravening any capital maintenance provisions. The income stream generated by Newco would be used to pay the interest charge and repay the capital amount.

2.3.3.2 Financing

The special characteristics of buy-outs is that the financiers provide the bulk of the funds but take a disproportionately small portion of the equity; on the other hand, the buy-out team obtains a large share of the equity but provides a small portion of the funding⁵⁰.

In most deals, the financial package will consist of a mixture of equity and debt. The key to every successful buy-out is arranging the correct balance between the basic financing elements, namely: the senior debt, the subordinated debt and the equity⁵¹, all of which represent differing risks and rewards⁵².

The major portion of financing in a buy-out will usually consist

⁵⁰ Thompson op cit note 31 at 42. Most financiers will require that the management sign personal suretyships for the loans provided to effect the buy-out. Although there is usually little chance of the management being in a position to honour these personal suretyships, the financiers believe that the very real possibility of a manager losing his life's savings, should the buy-out fail, lends added impetus to his endeavours to make the transaction work. (See Roux op cit note 21).

⁵¹ S Quickel 'Warnings Fail to Dim LBO Dazzle' (1986) Euromoney Survey: The Lucrative world of Management Buy-Outs 25. The characteristics of Senior Debt, Mezzanine Debt and Equity are set out in notes 53, 57 and 63 respectively.

⁵² For a discussion on risk and reward relative to the various financing alternatives see G H Koven and C Rafferty 'Structuring and Financing an LBO: A Conceptual Approach' 5ed Buyouts: Directory of Financing Sources (1989) 27.

of "senior debt"⁵³ normally between \pm 50% - 60%. "Senior debt" usually consists of secured term loans⁵⁴ repayable over 5 to 7 years. Due the exceptionally high gearing involved it is not unusual to see an interest moratorium⁵⁵ for the first year so as to allow the company's cash flow to stabilise after the buy-out⁵⁶.

"Junior or mezzanine debt"⁵⁷, usually makes up \pm 30% - 40% of the financing. It is generally a loan which is subordinated to the "senior debt". Although it is subordinated to the "senior debt" it is structured so as to rank above the concurrent creditors in the event of a liquidation of the company. This is usually done by way of an inter-creditor agreement in which the senior and junior lenders agree their respective rights and rankings⁵⁸. The careful structuring of subordinated debt has become imperative in the light of the recent judgement by Stegmann J in Ex Parte de Villiers NNO: In Re Carbon

⁵³ Senior debt is usually secured by way of collateral which may consist of a mortgage bond over the immovable assets of the company and a notarial bond over the company's movable assets. See L Blackstone and D Franks Guide to Management Buy-Outs (1986) 110 for a discussion regarding the types of security on which senior debt lenders can rely.

⁵⁴ Term loans are loans which are to be repaid over a fixed period of time. The loan may have a fixed interest rate which means that the interest rate remains unchanged for the duration of the loan; or the loan may have floating interest rate which means that the interest rate is linked to the prime overdraft rate and thus fluctuates as and when the overdraft draft moves.

⁵⁵ This simply means that no interest is payable on the debt for a period of time and is added to the capital amount and is repaid later.

⁵⁶ I Krieger Management Buy-outs (1990) 25.

⁵⁷ Junior or mezzanine debt (it is sometimes referred to as mezzanine debt because it bridges the gap between equity and "senior debt") is nothing more than inadequately secured high interest rate loans, which is similar to the North American junk bonds. See note 15 for an explanation of junk bonds.

⁵⁸ Krieger op cit note 56 at 25.

Developments (Pty) Limited (in Liquidation)⁵⁹. In his judgement Stegmann J held, inter alia, that subordination or "back ranking" agreements are invalid if they attempt to re-arrange the statutory claims in a concursum creditorum⁶⁰. It is submitted, therefore, that in order to ensure the validity of the subordination agreements the transaction must be structured in such a way so as to comply with the statutory ranking of claims⁶¹. The "junior debt" usually has a much higher interest rate than that of the senior debt. The reason being that the providers of "mezzanine finance" take a greater risk than secured lenders and accordingly require a higher return⁶².

The remainder of the financing will take the form of equity⁶³. The permutations of equity finance are enormous. The basic ordinary share ranks for dividend and repayment of capital behind virtually every other type of finance. This type of equity is usually attributable to the management team. Ranking ahead of the ordinary share is the preference share⁶⁴. The

⁵⁹ 1992 (2) SA 95 (W).

⁶⁰ See text at 119E-122H. See also Lind v Lefdal's Pianos Ltd (in Liquidation) and Others 1929 TPD 241 referred to by Stegmann J in his judgement.

⁶¹ In order to validly subordinate the mezzanine debt to the senior debt and ranking ahead of the claims of the concurrent creditors, by way of an example, it would be necessary for the financier providing the mezzanine debt to become a second bondholder over the assets of the company. Thereby complying with the statutory ranking as required by Stegmann J.

⁶² The interest rate payable on any loan is a function of the perceived risk of non-payment of the loan. This simply means that the higher the risk of non-payment the higher the interest rate. See note 52.

⁶³ Equity is essentially ownership. It is normally permanent and it is the highest risk finance. The equity shareholder has a right to income after all providers of finance have taken their return, and a right to whatever assets of the business remain after other providers of finance and creditors have been repaid (See I Krieger Management Buy-outs 23-24).

⁶⁴ R R Pennington Pennington's Company Law 6ed (1990) 206-216.

preference share usually carries a fixed dividend which is cumulative, that is if there are insufficient profits to distribute in any one period the right to the dividend is carried forward until the company does have sufficient distributable capital⁶⁵. The preference shareholder's rights rank behind providers of debt and trade or other creditors and, if specifically provided for, before ordinary shareholders⁶⁶. Usually the lending institution or financiers will take either preference shares (there are a number of combinations they can use, for example convertible preference shares, redeemable preference shares, convertible participating preference shares, etc⁶⁷ or convertible debentures. This will allow them to rank ahead of the management's shares⁶⁸, as well as benefiting from any future capital growth⁶⁹.

The following diagram graphically depicts the various layers of financing and levels of preference in the event of a liquidation.

⁶⁵ Ibid at 207-209.

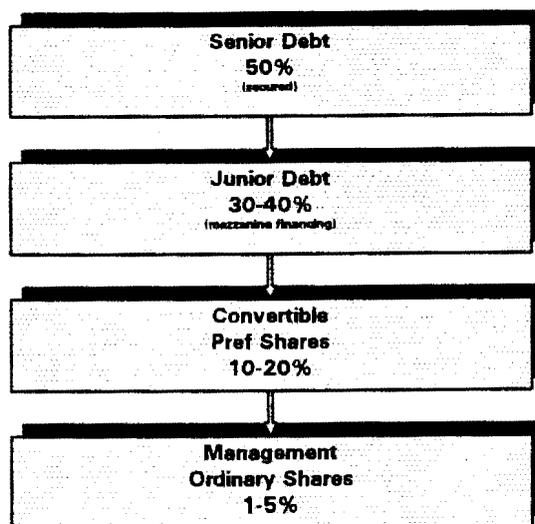
⁶⁶ Krieger op cit note 56 at 23. See the following cases relating to the rights of preference shareholders upon liquidation. See Ex parte Betty; In re First Mutual Investment Trust Ltd 1974 (1) SA 127 (W); Donaldson Investments (Pty) Ltd v Anglo Transvaal Collieries Ltd and Others 1983 (3) SA 96 (A) and J L Sher 'The Rights of Preference Shareholders: A Re-Examination' (1983) 7 SACLJ 87

⁶⁷ See L C B Gower Gower's Principles of Modern Company Law 4ed (1979) 412-423 and H S Cilliers and M L Benade Company Law 4ed (1982) 153-158 for discussions on the various types of preference shares.

⁶⁸ 'Management Buy-outs' (1987) Financial Mail Supplement 12.

⁶⁹ The fact that the financiers take an equity stake in the company makes a buy-out unique relative to other lending transactions. By providing loan and equity finance the financier not only earns interest income but also participates in the future prosperity of the company by way of dividends and capital growth which is concomitant with equity funding.

Diagram 3



In the event of insolvency of the buy-out company its assets may fall into either the category of "free residue" or "secured". Free residue is defined as that portion of an insolvent estate which is not subject to any right of preference by reason of any special mortgage, legal hypotheca, pledge or right of retention⁷⁰. The senior and junior lender will usually fall within the secured category and thus rank ahead of concurrent creditors⁷¹ (this is of course assuming the buy-out has been

⁷⁰ D Shrand The Law and Practice of Insolvency Winding Up of Companies and Judicial Management (1977) 126. See also E de la Rey Mars: The Law of Insolvency in South Africa 8ed 366-388 for discussions on the definitions of secured and preferent creditors as well as the various types of securities and the rights attaching to them.

⁷¹ See P Wood The Law of Subordinated Debt (1990) 50-71 for references relating to inter-lender agreements in jurisdictions outside South Africa. This work contains a detailed examination of the subordination of debt, subordination agreements, various classes of subordination and the distinctions between senior and junior debt. See Shrand op cit note 70 at 129 for the nature of the various types of security available to the senior and junior lender. See Ex parte De Villiers 1992 (2) SA 95 (W) for the courts attitude on subordination agreements and inter-lender agreements. See also footnote 61 for an explanation of how subordination of debt could validly be effected in South Africa.

structured to allow for this⁷²). Equity holders on the other hand will not only rank behind the senior and junior lenders but also behind all other concurrent and contingent creditors⁷³. Thus it is unlikely that the management team will receive any payout should the buy-out fail and the company liquidated.

2.3.4 Exiting from the buy-out

Raising finance and then servicing the debt is not the end of the transaction. Very often, at some point, the original investors in a Management Buy-Out will seek to realise their investment. When, how and for how much depends on a number of factors, *inter alia*, the historic growth rate of the company, the competence of the management team, the maturity of the company and the continuing acceptance of the company's products in the market place⁷⁴.

Investing institutions and in some cases the original management may seek a complete exit where the deal has been less than successful, or where future growth rates appear to be tailing off and more attractive investments are available elsewhere. Institutions generally view a buy-out as a five to seven year investment. The period is not strictly adhered to and is largely dependent on prevailing circumstances, the success of the buy-out and the institution's investment criteria⁷⁵.

In the event of the investors in the buy-out, whether management or financiers, wanting to realise their investment, they have the option of disposing of all or a portion of their shares to the other members of the management team or to a third party or they may list the company on the

⁷² See 2.3.3.1 for a discussion on how to structure a buy-out.

⁷³ See section 342 of the Companies Act (No.61 of 1973), as amended.

⁷⁴ I Krieger Management Buy-outs (1990) 42.

⁷⁵ Roux op cit note 21.

Stock Exchange⁷⁶. This latter option would entail offering a portion of the management and financier's shares to the the public for cash. This would generally leave the management and the financiers, if they so wish, with a much reduced shareholding in the in a publicly listed company. But this enables them to raise capital from the public in the future for expansion if necessary.

A successful buy-out can sometimes mean big returns and an unsuccessful one big losses due to the high levels of debt incurred to effect the buy-out. Some of the returns on the successful buy-outs are so disproportionately large relative to the initial investment, that it is little wonder that some former shareholders feel they have somehow been cheated. An excellent example of the kind of returns made, particularly in the United States, is that of Gibson Greeting Cards. This buy-out was led by Wesray Capital which bought Gibson from RCA for \$80 million, putting up only \$1 million of its own capital. A year and a half later the buy-out group took the company public again in an offering that valued Gibson at \$290 million. William Simon, the chief executive officer, saw his personal stake of \$330 000 transformed into \$66 million in cash and stock⁷⁷. These returns seem almost unbelievable and it is returns such as these that has angered the critics.

3. CRITICISMS OF MANAGEMENT BUYOUTS

3.1 Introduction

Management Buy-Outs earned a good reputation in the late 1970's and early 1980's as a means of saving failing divisions and companies. More recently however, larger buy-outs and larger profits for the buy-out team have

⁷⁶ For an in depth discussion on flotation of buy-out companies, reference is made to the book by M Wright, K Robbie and J Coyne Flotation of Management Buy-Outs (1987).

⁷⁷ L Hecht 'Message in Gibson Greeting Cards' (1986) Euromoney Survey 35.

brought that reputation into question⁷⁸. A former commissioner of the United States Securities Exchange Commission had this to say about "going private" buy-out transactions:

*"What is happening is, in my estimation, serious, unfair and sometimes disgraceful, a perversion of the whole process of public financing, and a course that inevitably is going to make the individual shareholder even more hostile to American corporate mores and the securities markets than he already is"*⁷⁹.

The main criticism to buy-outs is about fairness to shareholders. Critics like Stein and Lipper⁸⁰ find it difficult to see how management members of the buy-out team can serve effectively as fiduciaries of the selling shareholders and at the same time negotiate on their own behalf as buyers of the assets or business of the company. They claim that there is an inevitable breach of fiduciary duty arising from the irreconcilable conflict of interest facing the members of the buy-out team. Furthermore, they see the managers as the ultimate insiders, proxy to information not made available to the shareholders and therefore giving the buy-out team an unfair advantage⁸¹.

⁷⁸ K M Davidson 'Another look at LBO's' (1988) 9 The Journal of Business Strategy 44.

⁷⁹ R F Bruner and L S Paine 'Management Buy-Outs and Managerial Ethics' (1988) 30 California Management Review 89.

⁸⁰ B J Stein 'Going private is unethical' (1985) Nov Fortune 137 and A Lipper 'LBO's Based on Insider Information'(1987) Aug Venture 7.

⁸¹ S J Naude' Die Regsposisie van die Maatskappydirekteur Met Besondere verwysing na die Interne Maaatskapyverband (Unpublished LLD Thesis, University of South Africa, 1969) 200 et seq for his views on the question of the abuse of inside information and its relevance to directors.

3.2 Breach of Fiduciary Duty

3.2.1 Introduction

A company is an artificial legal entity with its own legal persona⁸², separate from its physical assets, members and workers. It has no body or corpus and must therefore operate exclusively through the medium of its directors, officers and employees⁸³. A director has been defined as a person who directs the affairs of the company⁸⁴. There are two classes of directors namely, outside (non-executive) directors⁸⁵ and inside (executive) directors⁸⁶. They have been distinguished them as follows:

-
- ⁸² O Britzius South African Company Secretarial Practice (1988) 3. See also M P Larkin 'Introduction and Formation to and of Companies'(1991) 4 The Law of South Africa 19-25 for a concise illustration of the corporate personality. See also Salomon v Salomon and Company All E R 33; [1897] AC 22; Dadoo v Krugersdorp Municipal Council 1920 AD 530; and Lee v Lee's Air Farming Ltd [1960] All E R 420; Privy Council [1961] AC 12 for the relevant case law in this regard.
- ⁸³ H S Cilliers and M L Benade Company Law 4ed (1982) 4. See the the judgement of Denning L J in H L Bolton (Engineering) Co Ltd v T J Graham & Sons Ltd [1956] All E R 624 and Watermeyer J in Estate Kootcher v Commissioner for Inland Revenue [1941] AD 256 wherein they liken a company to a human body.
- ⁸⁴ The Companies Act defines a director as including any person occupying the position of director or alternate director of a company, by whatever name he may be designated. P Meskin in his book Henochsberg on the Companies Act 4ed (1985) 9 argues that a director must be someone who has been appointed in that office by those in the company having power of appointment of directors (R v Mall 1959 (4) SA 607 (N) at 624 and S v Vandenberg 1979 (1) SA 208 (D) at 216 to 217) or if he is deemed to be a director in terms section 208(2) of the Companies Act (No.61 of 1973) as amended.
- ⁸⁵ See C Dillon The Non-Executive Director in Modern Company Law (Unpublished LLM Thesis, University of South Africa, 1986) for an overview of the duties of non-executive directors in South Africa.
- ⁸⁶ J T Pretorius (Ed) Hahlo's South African Company Law Through the Cases 5ed (1991) 327. In the case of Cronje NO v Stone en `n ander 1985 (3) SA 597 the distinction between executive and non-executive directors has been significantly curtailed. A non-executive director can now no longer proclaim to be unaccountable for vagrancies of his fellow exexecutive directors. If the court finds that the non-executive director has been dilatory in carrying out his duties, subject to certain latitudes, he could be be held accountable along with the other directors. See also Fisheries Development Corporation of SA Ltd v Jorgenson 1980 (4) SA 156 (W) which deals with the same issues.

"As a rule, the former attend and vote at meetings of the board, but do not work full-time for the company and have no service contract, whereas the latter have a service contract under which they work full-time for the company"⁸⁷.

In the context of Management Buy-Outs we are principally concerned with executive directors⁸⁸. The office of director, whether executive or non-executive, is a fiduciary one⁸⁹. The law relating to the fiduciary relationship of directors is clear; in their fiduciary position vis-à-vis the company, the directors may not place themselves in a position in which there is a conflict between their duties to the company and their personal interests. Where such a conflict arises it will lead to a breach of a director's fiduciary duty⁹⁰.

⁸⁷ J T Pretorius (Ed) Hahlo's South African Company Law Through the Cases 5ed (1991) 327.

⁸⁸ The reason is simply that executive directors are more likely than non-executive directors to form part of the buy-out team as they are actively involved in the day to day running of the business.

⁸⁹ J F Corkery Director's Powers and Duties (1987) 55. See also H S Cilliers and M L Benade Company Law 4ed (1982) 327-328 and O Britzius South African Secretarial Practice (1988) 84 for the position in South Africa.

⁹⁰ O Britzius South African Secretarial Practice (1988) 84. See also M S Blackman The Fiduciary Doctrine and its Application to Directors of Companies (1970) 275; H S Cilliers and M L Benade Company Law 4ed (1982) 327 and S J Naude' 'Die Regsposisie van die Maatskappy direkteur (1969) 159-187. Reference is made to Robinson v Randfontein Estates Gold Mining Company Ltd 1921 AD 168 at 179-180, Atlas Organic Fertilisers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd 1981 (2) SA 173 (T) at 197-199; Bellairs v Hodnett 1978 (1) SA 1109 (A) at 1126-1134 and Sibex Construction (SA) (Pty) Ltd v Injectaseal CC 1988 (2) SA 54 (T) which are some of the leading cases dealing with the fiduciary duties of directors.

3.2.2. Conflicts of Interest

3.2.2.1 Introduction

In the case of Robinson v Randfontein Estates Gold Mining Ltd⁹¹ it was held by Innes CJ that:

"Where one man stands to another in a position of confidence involving a duty to protect the interests of that other, he is not allowed to make a secret profit at the other's expense or place himself in a position where his interests conflict with his duty".

The critics argue that the buy-out process must, by its very nature, inevitably lead to irreconcilable conflicts of interest and consequently a breach of fiduciary duty⁹². It is submitted that the two main conflicts which arise are, first, that the directors cannot, as a result of their interest in the transaction, be impartial. The legal consequences of this partiality will depend on the ultimate structure of the buy-out. Where the assets of the company are purchased the directors are in direct breach of their fiduciary duties to the company. This arises as a result of the directors being duty bound to obtain the best possible price for the assets, yet, as potential purchasers in a buy-out transaction, wanting the lowest possible price in order to service the enormously high debt levels. In this case only the company and not the shareholders has a remedy in the event of a breach of fiduciary occurring.

⁹¹ 1921 AD 168. See also Aberdeen Railway Company v Blaikie Bros 1854 1 Macq 461 at 471 - 472, [1954] 2 All E R 1281.

⁹² B J Stein 'Going Private is Unethical' (1985) Fortune 137.

Where the buy-out team purchases the shares of the company as apposed to the assets, the conflict is somewhat different. The conflict is between the directors and the shareholders and not between the directors and the company. In Percival v Wright⁹³ Swinfen Eady J held that directors do not have a fiduciary duty to individual shareholders when purchasing shares⁹⁴ and as such need make no disclosure to shareholders of *"...a large casual profit, the discovery of a new vein, or the prospect of a good dividend in the immediate future..."*

It is submitted that in the light of the above case, where the buy-out team purchases the shares of the company, it cannot be said that there is a breach of fiduciary duty⁹⁵. However, where the directors are privy to unpublished price sensitive information not disclosed to the shareholders or to the public at large and trade in the company's shares, they will fall foul of anti-insider trading regulations, which is dealt with in 4.4 below.

Secondly, the directors may identify, prior to the buy-out, certain assets of the company which, if re-deployed or sold, could add substantial value to the company, but only

⁹³ [1902] 2 Ch 421.

⁹⁴ In Allen v Hyatt (1914) 30 TLR 444, however, the directors were held accountable to the shareholders on the basis of misrepresenting the affairs of the company in order to induce the shareholders to sell their shares to them. The court held that in the specific circumstances of the case the directors were acting as agents for the shareholders and were consequently accountable for the profit which they had improperly obtained. See also R R Pennington Pennington's Company Law 6ed (1990) 609-611.

⁹⁵ See S J Naude' Die Regsposisie van die Maatskappydirekteur (1969) 200-215.

implement such strategies after the transaction is completed⁹⁶.

It is submitted that these conflicts could lead to the management team failing to pay a fair price to the erstwhile shareholders; and this in turn could lead to secret profits being made by the management team as a result of the team's self interest.

3.2.2.2 Fair price

It is submitted that there can be no argument against the fact that in a non-arms length transaction the temptation always exists not to pay a fair price⁹⁷ for the assets or alternatively the

⁹⁶ The company director is under a general duty to act honestly in the best interests of the company. However, this duty is not as onerous as it at first seems. The courts have attributed a low standard of care in deciding whether or not the director has in fact done so. The director is not expected to have special skills other than he already has, provided he acts honestly. See L C B Gower Gower's Principles of Modern Company Law 4ed (1979) 576-580, O Britzius South African Company Secretarial Practice (1988) 94-95 and R R Pennington Pennington's Company Law 6ed (1990) 600-603. For the relevant case law in this regard see Lagunas Nitrate Co v Lagunas Syndicate [1899] 2 Ch 392, Parke v Daily News Ltd [1962] 2 All E R 929 and Fisheries Development Corporation of S A Ltd v Jorgenson 1980 (4) SA 156 (W).

⁹⁷ The term fair price is far more complicated than it at first appears and very difficult ascertain. Value is a subjective concept and the value of an interest in an enterprise to one investor may differ from the value to another investor (See Merchant Bankers Association Working Paper on Valuations 21 February 1992 Ref No:8062/MA 06). This is not the the only problem, before the the value of the enterprise can be determined, the type of value must be ascertained. There are many different types of value. The most commonly used terms are the Going Concern Value, Liquidation Value and Market Value. The Going Concern Value is generally attributed to a an enterprise which has an established plant or business with its earning power already partly or entirely matured. Liquidation Value is the value placed on the net amount realisable on the assets in the event of bankruptcy or liquidation. This basis of valuation recognises that so called "distress merchandise" realises less than fair market value. Market Value can be further sub-divided into Open Market Value, Notional Market Value and Fair Market Value. Open Market Value is usually the price negotiated between a vendor and a purchaser acting at arms length. The Notional Value is a value attributed to an enterprise in the absence of Open Market Valuations (e.g negotiations between non-arms length parties) by making certain assumptions of what a fair price should be. Fair Market Value is the highest price available estimated in terms of money

shares of the company, particularly in a buy-out situation.

To mitigate the appearance of such self dealing in these non-arms length acquisitions, managers virtually always engage an investment banker to express an independent opinion that the buy-out compensation represents fair value⁹⁸.

Stein argues that this is insufficient⁹⁹. He avers that the investment banker cannot be trusted to give a truly independent opinion on whether the price for the business or its shares is fair and reasonable. This is particularly the case when an offer is being made for the buy-out company as a going concern, regardless of whether the shares or the assets is being purchased. He suggests that either they see it as an opportunity to make money or they are not given sufficient information to form an opinion. He is clearly not the only one who believes this, considering the amount of "fair compensation" litigation that is generated in the United States following buy-out bids. The public shareholders claim that the management team's informational advantages are not available

which a willing seller may obtain for the property in an open and unrestricted market from a willing, knowledgeable purchaser acting at arms length. See I Cambell Canadian Valuation Service (1991) 4-20B. See also P Feinberg 'The Price of Industry' (1990) 19 Businessman's Law 129; T Copeland Valuation: Measuring and Managing the Value of Companies (1990), O G Sexton 'Measuring the Value Gap: A Survival Exercise for Management' (1989) 2 M & A Europe 33 and J T Pretorius (Ed) Hahlo's South African Company Law Through the Cases 5ed (1991) 187-193 for further reading on this topic. For the relevant case law relating to valuations see Jones v Jones [1971] All E R 676, Dublin v Diner 1964 (1) SA 799, Estate Milne v Donohoe Investments (Pty) Ltd 1967 (2) SA 359 (A), Donaldson Investments (Pty) Ltd v Anglo-Transvaal Collieries Ltd 1979 (3) SA 713; confirmed on appeal 1980 (4) SA 204 (T); and on further appeal 1983 (3) SA 93 (A), and Ex parte Macey's Stores Ltd 1983 (2) SA 657 (Z).

⁹⁸ L E De Angelo 'Accounting Numbers as Market Valuation Substitutes: A Study of Management Buy-Outs of Public Stockholders'(1986) 61 Accounting Review 400.

⁹⁹ B J Stein 'Going Private is Unethical' Fortune 138.

to the appointed investment bankers or to the shareholders¹⁰⁰.

Apart from the informational disadvantages suffered by the investment banker and the shareholder, a far more serious allegation is levelled at the directors. It has been alleged, not only by Stein and Lipper, that because the investment banks and courts rely heavily on the capitalised earnings method of valuation¹⁰¹, the managers are in a unique position to manipulate the earnings. The Wall Street Journal¹⁰² voiced its concerns in the following item-

"Regulators and some businessmen are concerned about management's ability to manipulate financial results to make a leveraged buy-out easier or cheaper. Such manipulation could involve holding down current earnings and strengthening future profits by making costly improvements to plant and equipment or by introducing more conservative accounting procedures."

It is submitted that, if this were in fact the case, management would be in a position to offer what appears to be a healthy

¹⁰⁰ H De Angelo and L E De Angelo 'Management Buy-Outs of Publicly Traded Corporations' (1987) 33 Financial Analysts Journal 47.

¹⁰¹ The capitalised earnings method of valuation of the company, regardless of whether the business or the shares are being valued, takes the following form: The historic earnings of the company are normalised (that is any extra-ordinary items are either added back or subtracted depending on their nature) and weighted to the extent to which they are sustainable. This generally means that the most recent results and forecasts are accorded the heaviest weighting. Once this figure is obtained, a price earnings multiple (a figure calculated to indicate how many years it will take the investor to recoup his investment at the company's present after tax earnings) is then applied to this figure (the multiple is generally based on comparable companies on the Stock Exchange). The result would theoretically be the value of the company. For a more in-depth discussion relating to the capitalised earnings method of valuation see D Clutterbuck and M Devine Management Buyouts 49-52, I Krieger Management Buy-outs 17-19 and L Blackstone and D Franks Guide to Management Buy-Outs 1986-1987 12.

¹⁰² 29 December 1983 1.

premium to the market price, when in fact the market price does not reflect the true potential of the company¹⁰³. This means that even if the company is put out to tender (after the buy-out bid is made), the quality of the information is such that the management team could no doubt still be in a position to offer the higher price, confident in the knowledge that it could recoup it at a later stage. Therefore, the management have an unfair advantage over its shareholders and, in the case of an auction sale or tender offer, over other bidders.

3.2.2.3. Self interest and secret profits

The issues raised by self interest and secret profits vary depending on whether the assets or the shares of the company are purchased. If the shares are purchased and the managers are privy to information not available to the public there is no breach of fiduciary duty in the true sense of the word¹⁰⁴. The managers have no fiduciary duty to the shareholders, only to the company itself. The rules governing this instance

¹⁰³ There appears to be no reason why, in South African law, a company's auditors could not be held liable to third parties for negligence if the financial position of the company was incorrectly reported, as long as the necessary negligence or intent is proved. See H S Cilliers and M L Benade Company Law 4ed (1982) 497-539, J T Pretorius Hahlo's South African Company Law Through the Cases 5ed (1991) 603-646 and S Trusswell and H Norval 'Preventing Corporate Fraud' (1989) 19 Businessman's Law 31, J T Pretorius Aanspreeklikheid van die Maatskappy-Ouditeure tenoor derdes op grond van Warvoorstelling van Finansiële State (1985) 396ff and C R Cookson and D J McQuoid - Mason 'Twentieth Century Auditors: Watchdogs, Bloodhounds or Crossbreeds?' 1975 Natal University LR 164 for more details on the South African position. In regards to the position in the United Kingdom reference is made to the article by K P E Lasok and E Grace 'The True and Fair View' (1989) 10 Company Lawyer 13. This article also explores the effect of the true and fair criteria on the issue of creative accounting. See the following cases in this regard Lipschitz v Wolpert 1977 (2) SA 732 (A), Pacific Acceptance Corporation Ltd v Forsyth (1970) 92 WN (NSW) 29, Tonkwane Sawmill Co Ltd v Filmalter 1975 (2) SA 453 (W).

¹⁰⁴ See Percival v Wright op cit note 93.

would therefore fall within the realm of insider trading¹⁰⁵. Where the assets of the company are purchased an altogether different set of rules apply. It is an inflexible rule of equity that a person who is in a fiduciary position is not entitled to profit from that position¹⁰⁶. Where a director has made a profit by reason of his office, he must account to his company for all all profits acquired by him, unless acquired or retained with the full knowledge and consent of his company¹⁰⁷.

The critics argue that whatever the structure, the managers benefit at the expense of the shareholders¹⁰⁸ because of their insider knowledge and their interest in the transaction. The fact that certain companies have shown an almost embarrassing turnaround underscores this assertion. The critics accept that higher levels of motivation are present when managers own the business. They also accept that certain areas of the business can be rationalised which can lead to substantial savings¹⁰⁹. What they cannot accept is that the entire turnaround is due solely to "turning off the lights and

¹⁰⁵ Insider trading is dealt with in detail in 4.4.

¹⁰⁶ Regal (Hastings) Limited v Gulliver [1942] 1 All E R 378; [1967] 2AC 134. See also Robinson v Randfontein Estates 1921 AD 168 and M S Blackman 'Directors and Officers' (1991) 4 The Law of South Africa 217-221, M S Blackman The Fiduciary Doctrine and its Application to Directors of Companies (1970) 262-273, M Larkin 'The Fiduciary Duties of the Company Director' (1979) South African Company Law Journal E31-E40 and J J du Plessis Maatskaplike Grondslae van die Regsposisie van Direkteure en Besturende Direkteure (Unpublished LLD Thesis, University of the Orange Free State, 1990) 132-146 for discussions on this topic.

¹⁰⁷ Robinson v Randfontein Estates 1921 AD 168.

¹⁰⁸ B J Stein 'Going private is unethical' (1985) Nov Fortune 137 and A Lipper 'LBO's Based on Insider Information' (1987) Aug Venture 7.

¹⁰⁹ By way of an example, Macy's department store, used the simple expedient of providing identical bags for all its stores and buying them in bulk and saved a \$1 million per annum (B Little 'The Conscience of Wall Street' (1989) Barrons 82.)

using pencils until they are shorter¹¹⁰. The real reason for the turnaround they say, is far more elementary. The management know exactly where the real values of the corporation lie, where costs can be reduced and productivity improved. Once the buy-out is completed, whole divisions and other corporate assets are sold off, debt repaid, leaving a company with virtually the same cash-flows as before¹¹¹.

They continue by arguing that if the directors know of a way to re-align corporate assets so as to realise more value, they are legally as well as ethically bound to identify and execute these strategies for the benefit of the stockholders. If they do not, they must account to the company for any benefits which have accrued to them due the belated execution of strategies which would have enhanced shareholder value¹¹².

3.3 Insider Trading

A Management Buy-Out, says Dan Dalton is the ultimate in inside information. He contends that if trading on inside information for a few thousand shares (or, indeed one share, for that matter) is in violation of federal securities law, then how can the buy-out be conducted in anything resembling good faith. Who else, he continues, has more pertinent information about the strengths, weaknesses, threats and opportunities facing an organisation than the company's management¹¹³.

¹¹⁰ A Lipper 'LBO's based on insider information' (1987) Venture 7.

¹¹¹ B J Stein 'Dear Mr Ruder-Your view of LBO's is Dead Wrong' Jan (1989) Barrons 44.

¹¹² Ibid.

¹¹³ D Dalton 'The Ubiquitous Leverage Buy-Out (LBO): Management Buy-Out or Management Sell-Out' (1989) 32 Business Horizons 38.

Insider trading may be described as the practice of dealing in the securities of a company on the strength of unpublished price sensitive information¹¹⁴. Insider trading has been the subject of intense discussion for many years¹¹⁵. In South Africa the various issues were explored at length by the Van Wyk de Vries Commission¹¹⁶. The Commission decided, based on the premise that insider trading has an adverse effect on on the confidence of the public.

It has also been argued that insider trading should be permitted. Insiders, it is said assist the market to function efficiently in correctly reflecting the variations of corporate fortunes. The insider knows of information that would indicate that his own view of the market reflects the correct level of share prices, and that it is the market which is ill informed. Thus, the insider positively assists in bringing about a true state of affairs¹¹⁷.

In any event to base the total prohibition of insider trading on the argument

¹¹⁴ R Jooste 'Insider Trading'(1991) 20 Businessman's Law 248. Section 440F(2)(a) of the Companies Act (No.61 of 1973), as amended, defines unpublished price sensitive information as information which-

- (i) relates to matters in respect of the internal affairs of the company or its operations, assets, earning power or involvement as offeror or offeree company in an affected transaction or proposed affected transaction;
- (ii) is not generally available to the reasonable investor in the relevant markets;
- (iii) would reasonably be expected to affect materially the price of such security if it were generally available;

¹¹⁵ B A K Rider Insider Trading (1983) 1 and L C B Gower Gower's Principles of Modern Company Law 4ed (1979) 630-640

¹¹⁶ Main Report of the Commission of Enquiry into the Companies Act RP 45/1970 prepared by an undisclosed committee. See B A K Rider 'The Regulation of Insider Trading in the Republic of South Africa'(1977) 94 SALJ 437 for a review of the issues relating to insider trading which faced the Commission during its sitting. The article also contains a discussion on the various shortcomings of the anti-insider trading provisions contained in the 1973 Companies Act arising from the Commission's recommendations.

¹¹⁷ B A K Rider Insider Trading (1983) 1. See also B Kantor 'In Support of Insider Trading' (1991) 20 Businessman's Law 167 for a South African argument in favour of permitting insider trading and S Davidson's article 'Insider Trading: A reply to Brian Kantor' (1991) 21 Businessman's Law 94 for the contra-argument.

of fairness was referred to by Henry Manne as "being a product of irrational self righteous indignation"¹¹⁸. Barry Rider to some extent agrees with him, but for different reasons. He argues that insider trading should not be prohibited merely because it is immoral. It should rather be prohibited because insider trading lowers the integrity of the market and thus the confidence that is reposed in it as a fair, efficient and economic allocator of scarce capital resources is eroded¹¹⁹. Therefore, he says, the primary justification for anti-insider trading regulation must be the protection and promotion of investor confidence in both the integrity and efficiency of the securities market.

In the light of the considerations as set out by Rider, the overriding premise in the formulation of anti-insider trading regulations appears to be that

"[t]he law should try and ensure that all individuals in the market are placed on an equal footing in so far as possible. This requires, firstly, timely and adequate disclosure by companies of price sensitive information and secondly, the prohibition of dealing on any such information which is undisclosed"¹²⁰.

The premise upon which the anti-insider trading regulations is based and the buy-out process are, argue the critics, mutually exclusive. Namely, that the directors are the ultimate insiders and unless provision is made for substantial disclosure, shareholders and other investors will, to their detriment, never be placed on an equal footing.

¹¹⁸ Rider op cit note 115 at 2.

¹¹⁹ B A K Rider Insider Trading (1983) 1.

¹²⁰ J H Farrar, N Furey and B Hannigan Farrar's Company Law 2ed (1988) 366.

4. THE ARGUMENTS IN FAVOUR OF MANAGEMENT BUY-OUTS

4.1 Introduction

It is submitted that the critics of Management Buy-Out's have been blinded by the enormous profits made by the buy-out teams in the past. It appears to them criminal that the management team should make vast fortunes while they, as shareholders, have made very little. The feeling is understandable but business cannot sustain their requests to have buy-outs prohibited or constrained to such an extent as to become unworkable.

4.2 Fair Price

4.2.1 Disclosure

Value, like beauty, is in the eye of the beholder¹²¹. It has often been said that a fair price is one settled upon by a willing buyer and a willing seller. However, in the case of a buy-out, this maxim should contain the words "informed seller". This lack of information appears to be the critics greatest anathema and the one most easily rectified. Disclosure is a widely used panacea for most conflicts of interest¹²². It is submitted that there are so many disclosure provisions that it is unnecessary to enact even more to quell the fears of the critics. All that needs to be done is the rigorous application of the existing provisions.

The City Code in London has decreed¹²³ that when the buy-out team

¹²¹ M Fishbein 'Valuation-an Ozymandian Task'(1988) July Corporate Finance 37.

¹²² L Sealy 'The Disclosure Philosophy and Company Law Reform' (1981) 2 Company Lawyer 51. See also H Kripke 'The Myth of the Informed Layman' (1973) 28 Business Lawyer 631 for his views on the oversimplification of disclosure principles.

¹²³ C Latter 'Panel MBO Changes - Conflicts of Interest' (1990) FT Mergers and Acquisitions XXVIII. See also Rule 19.4 of the London City Code on Take-overs and Mergers for the position in the United Kingdom regarding the equality of

supplies its own financial backers with confidential information concerning the financial position and prospects of the target company; it must make such information available to the independent directors and financial advisors who must assess and recommend the terms of the proposed offer, and to any person who is making a competing offer. It also requires that the buy-out team disclose all internal management information which they may use in arranging the financial backing. The independent non-executive directors are to retain, as early as possible, truly independent financial advisors. The buy-out directors may not express any opinion on the offer and must explain their conflict of interest to the shareholders¹²⁴. It is submitted that this decree has addressed the problems and conflicts highlighted by the critics in that it requires full disclosure, thereby enabling third parties (whether independent advisers or shareholders) from establishing the true value of the company.

In South Africa the Securities Regulation Code on Take-Overs and Mergers¹²⁵, contains the following provision dealing with disclosure during a buy-out¹²⁶.

"If the offer or potential offer is for a management buy-out or similar transaction, the offeror or potential offeror shall, on request, forthwith furnish the independent directors [i.e. directors not involved in the buy-out] of the offeree company and its advisers with all information which has been furnished by the offeror or potential offeror to external providers or potential providers of finance (whether equity or debt) for the buy-out."

information.

¹²⁴ Latter Ibid.

¹²⁵ Published by R 29 in Government Gazette No 12962 of 18 January 1991 The code came into operation on 1 February 1991.

¹²⁶ See Rule 17 of the South African Securities Regulation Code on Take-Overs and Mergers.

It is submitted that by requiring disclosure, it is possible to effect in respect of corporate conduct what could otherwise only have been achieved by detailed regulation. There are scores of disclosure provisions both statutory and in the common law which can be relied upon to force the directors to make the necessary revelations¹²⁷.

It is further submitted that to prohibit buy-outs merely because its critics feel that they are not being provided with sufficient information in order to determine a fair price, serves no commercial purpose. The disclosure provisions in the Securities Regulation Code on Take-Overs and Mergers relating to Management Buy-Outs along with the other statutory and common law and Regulatory disclosure requirements¹²⁸, satisfactorily protect

¹²⁷ There are a variety statutory disclosure requirements in the Companies Act (No.61 of 1973), as amended. The directors have both a common law duty (See Robinson v Randfontein Estates Gold Mining Co Ltd 1921 AD 168) and a statutory duty (See section 234 to section 238 of the Companies Act (No.61 of 1973), as amended) to disclose their interests in a contract. In terms of section 228 of the Companies Act (No.61 of 1973), as amended, the general meeting must approve the disposal of the whole or substantially the whole of the undertaking of the company by way of an ordinary resolution. Although there is no statutory duty of disclosure in this case, the shareholders can refuse to approve the disposal unless adequate disclosure is provided. Despite these disclosure requirements, where the shareholders are not in a position to block the disposal, they have a remedy in sections 252 and 266 of the Companies Act (No.61 of 1973), as amended or in terms of the common law if it is clear that there has been an oppression of minorities. (See D S Ribbens 'Disposal of the the undertaking or whole or greater part of the assets of the company' (1976) 39 THRHR 162 and P E J Brooks 'Section 228 of the Companies Act (1987) 50 THRHR 226 for further reading on this topic.).

¹²⁸ See footnote 127 for details on the various statutory disclosure requirements. In the case of 'going private' transactions the Johannesburg Stock Exchange requires substantial disclosures when there is a disposal or aquisition of assets making up at least 15% of the issued share capital and realised reserves of a listed company. It requires information relating to the nature of the assets sold or bought, the price, interests of directors, vendor's agreement etc. They also require an Auditor's Report giving financial details of the transaction and a fair and reasonable statement from the auditors or a Merchant Bank (See Rule 18 in section II of the Listings Requirements of the JSE read with Rule XI of the Practice notes) attesting to the fairness of the transaction. Where the shares are being purchased involving a change of control, similar disclosure requirements are required by the Securities Regulation Panel (See Rule 21 of the Code read with section III of the Listings Requirements of the JSE). They would also require that a similar offer be made to all the minorities in the event control changing which in itself requires certain disclosures (See Rule 8 read with Rule 22 of the Code).

shareholders against an unscrupulous management team who purposely withhold information for their own benefit.

4.2.2. Fair price determination

The allegations of manipulation of the earnings figures, although possible, are generally improbable. This conclusion was reached by Linda De Angelo after conducting in-depth empirical research on this point¹²⁹. She concluded that the reason why managers do not systematically understate earnings is because earnings are sufficiently important to attract careful scrutiny by the parties who would be adversely effected by a successful strategy of income manipulation. Due to the severity of the managerial conflicts of interest in a buy-out situation, public stockholders and their financial advisors invest resources to examine the company's financial statements for income-reducing accounting techniques by the incumbent management¹³⁰. It is submitted that, in the light of this and other research, the critics allegations of earnings manipulation are generally without foundation. It does not, however, mean that such manipulation is impossible, but it is submitted that to prohibit buy-outs merely because some remote possibility of income manipulation exists, is untenable¹³¹.

¹²⁹ L E De Angelo 'Accounting Numbers as Market Valuation Substitutes: A Study of Management Buy-Outs of Public Stockholders'(1986) 61 Accounting Review 401.

¹³⁰ Ibid at 418. An example of income manipulation may be where the management have known for some time that they are going to make a bid for the company. They upgrade the entire plant at great cost, effectively doubling the plant's capacity but continue to run it at its historic capacity. The earnings will drop due to the massive capital expenditure which has been incurred. The assets are then subjected to some form of accelerated depreciation thereby reflecting a fixed asset figure in the balance sheet which is much lower than would ordinarily be the case. When the bid is made the price appears to be fair if based on the financial statements, but would not even begin to reflect the true potential of the company. After taking control of the company or its assets, production is doubled and the business suddenly begins to generate massive profits. The loans are repaid and a few years later the management exit from the buy-out having made a fortune.

¹³¹ For references to contra-arguments see L E De Angelo 'Accounting Numbers as Market Valuation Substitutes: A Study of Management Buy-Outs of Public Stockholders'(1986) 61 Accounting Review 401 footnote 1.

4.3 Self interest and secret profits

Stein alleges that directors of companies know where the real values lie in a corporation, where the opportunities for squeezing out extra value are, and how to make the corporation yield as much money as possible in either sale or operational mode. He says first, that this is tantamount to secret profits and must be accounted for; and secondly that the legislature should prohibit buy-outs so as to prevent it from happening in the first place¹³².

It is submitted that the first part of Stein's argument has some merit in theory, but on a practical basis, both it and the second part are in most respects untenable. When the assets are sold to the directors and they have not disclosed the assets' true worth to the company or its shareholders, the shareholders are, via the company, fully entitled in common law¹³³ to require the directors to account for any "secret profits"¹³⁴, albeit to the company. However, certain practical problems exist. First, if the aggrieved shareholders are no longer shareholders of the target company¹³⁵ they have no locus standi and can no longer force the directors to account for the profits made as a result of the non-disclosure¹³⁶. This

¹³² B J Stein 'Dear Mr Ruder-Your view of LBO's is Dead Wrong' Jan (1989) Barrons 44.

¹³³ H S Cilliers and M L Benade Company Law 4ed (1982) 561-570 for a discussion on the common law. See also section 266 of the Companies Act (No.61 of 1973), as amended for the statutory derivative action.

¹³⁴ See Robinson v Randfontein Estates Gold Mining Co Ltd 1921 AD 168 and Regal (Hastings) Ltd v Gulliver [1942] 1 All E R 378.

¹³⁵ There is a very real possibility that by the time the shareholders realise that inordinate profits have been made by the management as a result of non-disclosure, the shareholders would either have sold their shares in the "cash shell"(a company whose only asset is cash) or the company may have been wound up.

¹³⁶ Foss v Harbottle (1843) 2 Hare 461, 67 All E R 189. See also H S Cilliers and M L Benade Company Law 4ed (1982) 563-570 for further discussion on this topic. See also O Schreiner 'The Shareholders's Derivative Action-A Comparative Study of Procedures' (1979) 96 SALJ 203 for a discussion on the derivative action in various jurisdictions and also S J Naude' Die Regsposisie van die Maatskappydirekteur

problem can be solved, however, if the shareholders had subsequently sold their shares in the "cash shell" to the directors. If this were the case the aggrieved shareholders could either cancel the sale of shares on the basis of contractual misrepresentation¹³⁷ and have the Member's Register rectified¹³⁸ or could invoke the common law remedy available to them under the Lex Aquilia¹³⁹ and claim damages for any loss arising as a result of the material non-disclosure.

Where the management team buys the shares of the target company the problems relating to locus standi and the accountability by the directors of secret profits do not exist. In the event of there having been misrepresentation by the management, the aggrieved shareholder can rely on the contractual and delictual remedies as set out in the common law which have been discussed above or on the statutory remedy under the anti-insider trading regulations¹⁴⁰.

Secondly, to require management to account for secret profits is easier said than done. It is submitted that the aggrieved shareholder will find it difficult, if not impossible, to prove which portion of the profits made by team, post the buy-out, was made as a result of non-disclosure prior to the transaction.

As regards Stein's second contention; it has long been recognised that,

(1969) 236-246 on this topic.

¹³⁷ See J F Coaker and D T Zeffertt Mercantile Law of South Africa 18ed (1984) 91-115 for details of the common law remedies regarding misrepresentation and S J Naude' Die Regsposisie van die Maatskappydirekteur (1969) 203-206 for his views.

¹³⁸ See section 118 of the Companies Act (No.61 of 1973), as amended.

¹³⁹ See Pretorius v Natal South Sea Investment Trust Ltd 1963 (3) SA 410 (W) and the recent Appellate Division case of Bayer South Africa (Pty) Ltd v Frost 1991 (4) SA 559 (A) which has at last accepted the principle of delictual liability for pure economic loss where there has been negligent misrepresentation during the course of the negotiation of a contract.

¹⁴⁰ Insider trading is dealt with in detail later in this work.

where a director has an interest in a contract entered into by his company, a danger of a conflict of interest always exists¹⁴¹. It is submitted that where such a situation occurs, the law recognises that, despite his best intentions, the director may be swayed by his own self interest and as such, shareholders must be protected as far as possible. The common law and the legislature did not, however, see it fit to prohibit the contract wherein the director has an interest. Rather, it required that there be adequate disclosure¹⁴² of the interest (adequate disclosure means that all relevant details are to be disclosed¹⁴³). It is submitted that the conflict facing the directors in a buy-out transaction can be no more onerous than the conflict facing the directors interested in a contract entered into by the company, thus in the light of the above there can be no reason why buy-outs should be prohibited merely because there is a degree of self interest involved.

4.4. Insider Trading

The 1989 Companies Amendment Act (No.78 of 1989) and the 1990 Companies Amendment Act (No.69 of 1990) contained new provisions relating to insider trading¹⁴⁴. These Acts replaced the old section 233 of the Companies Act (No.61 of 1973), as amended. The reason for this

¹⁴¹ H S Cilliers and M L Benade Company Law 4 ed (1982) 346-349. See R C Clark Corporate Law 1ed (1986) 159-189 for the position in the United States of America, L C B Gower Gower's Principles of Modern Company Law 4 ed (1979) 584-602 for the position in the United Kingdom.

¹⁴² Although a director's common law duty of disclosure of a material interest in a contract is to the company in general meeting, sections 234 - 241 of the Companies Act (No.61 of 1973), as amended, permits such disclosure of interest in contracts to be made to the other directors acting on behalf of the company (provided it is permitted by the Articles). It would clearly be impractical to convene a general meeting every time a contract in which a director was interested needed to be ratified (See O Britzius South African Company Secretarial Practice (1988) 88-92 and S J Naude' Die Regsposisie van die Maatskappydirekteur (1969) 176-187.)

¹⁴³ See Novick v Comair Holdings Ltd 1979(2) SA 116(W)

¹⁴⁴ These amendments are now contained in section 440F of the Companies Act (No.61 of 1973), as amended.

amendment says Jooste, is that the provisions introduced in 1973 were ineffectual and not a single prosecution for their contravention has occurred¹⁴⁵.

The new Section 440(F)(1) of the Companies Act (No.61 of 1973), as amended provides that:

"Any person who whether directly or indirectly, knowingly deals in a security on the basis of unpublished price sensitive information in respect of that security, shall be guilty of an offence... ."

This new amendment has significantly increased the scope of the Companies Act's anti-insider trading provisions. The new provisions ensnare three categories of recalcitrants: first, the "primary insider", who by virtue of a relationship of trust or other contractual relationship has access to inside information; secondly, the outsider or "tippee" who obtains the inside information from the primary insider or from another tippee either voluntarily or inadvertently; thirdly, a person, whether an insider or an outsider, who gains access to inside information through espionage, theft, bribery, fraud, misrepresentation, or any other wrongful method¹⁴⁶.

It is submitted that implementation of section 440F(3) has also made it easier to prosecute the perpetrators of insider trading. This section provides that if it is proved that the accused was in possession of unpublished price-sensitive information in respect of the security in question at the time of the alleged offence, he or it shall be deemed, unless the contrary is proved, that he knowingly dealt in that security on the basis of such information. Therefore, if it can be proved that a person was in possession of insider information and dealt in that security, it is presumed that there had

¹⁴⁵ R Jooste 'Insider Trading-A New Clampdown' (1991) 20 Businessman's Law 248.

¹⁴⁶ Ibid.

been insider trading.

The onus is thus passed onto the accused to prove, on a balance of probabilities, that he did not deal in the shares on the basis of such information.

In South Africa the penalties for insider trading have also been considerably bolstered in the new provisions by allowing the courts to sentence the perpetrator to a fine not exceeding R500 000 or to a term of imprisonment not exceeding 10 years or both¹⁴⁷.

In addition to the fortified criminal liability for insider trading, the new anti-insider trading regulations also contain provisions for a civil action by the aggrieved party. In terms of section 440F(4)(a) of the Companies Act

"Any person who contravenes subsection (1) shall be liable to any other person for any loss or damage suffered by that person as a result of such a contravention."

Section 440(4)(b) provides that:

"In the case of of dealings in a security on a stock exchange or financial market as defined in section 1 of the Financial Markets Control Act, 1989, (Act No.55 of 1989), the plaintiff shall not need to prove intention or negligence towards him or it an action contemplated in paragraph (a)."

This statutory civil remedy seems, at first blush, to be a major departure from the inefficiencies of the past. This says Jooste is not the case¹⁴⁸. He

¹⁴⁷ See section 441(1) as to the penalties for insider trading.

¹⁴⁸ R Jooste 'Insider Trading in South Africa' (1991) 107 SALJ 603.

argues that in the great majority of cases of instances resorting to the civil remedy is a exercise in futility. The reason he says is that there is no causal link or nexus between the contravention of the criminal provisions of section 440F and the loss or damage. This is due to the fact that the alleged victim would, in the case of a stock exchange dealing, have traded at the price in any event regardless of the fact that there had been insider trading. The damage or loss contemplated by the legislature was the difference between what the victim would have paid had the inside information been known and what he paid. This, Jooste argues, cannot be correct as the loss arose not because of the insider trading but because the inside information was not made public. Thus no casual link is present.

It is respectfully submitted that this argument is flawed. The learned writer has imputed the essentialia of causation contained in the common law remedy into the statutory remedy. It is submitted that causation, although essential in the common law remedy of delict, has by implication been dispensed with in the statutory remedy, just as the requirement of negligence or intention has been dispensed with in Stock Exchange dealing. An aggrieved party would have to show only that the insider contravened the criminal provisions of section 440F and not that the perpetrator's insider trading caused him damage. In order to prove his damages, the aggrieved person may need to retain experts to show what the true price should have been had the inside information been publicly available. In the case of a stock exchange transaction he would not have to prove negligence or intention, but would need to do so in the case of a non-stock exchange transaction¹⁴⁹.

It is submitted that in the case of Management Buy-Outs the aggrieved shareholder can rely on this remedy if he believes that the directors of the buy-out company have made profits at his expense through some inside

¹⁴⁹ Ibid.

knowledge. It suggested that this claim like any other claim will prescribe after three years¹⁵⁰.

One last issue to be discussed is that of access to information by an aggrieved party to allow him to prosecute his claim. As the law stands at present, an aggrieved person has no right to any information relating to the affairs of the company once he is no longer a shareholder of the company¹⁵¹. Nor has he any right to inspect the financial statements unless it is a public company and he can obtain the accounts from the Registrar of Companies¹⁵². It is submitted that this is a lacuna in the law as an erstwhile shareholder may only realise that he has been a victim of insider trading when he perchance learns of the massive profits that the company is making.

5. CONCLUSIONS AND RECOMMENDATIONS

In the late 1970's and early 1980's Management Buy-Outs were acclaimed as the saviours of failing divisions and companies and a means of re-vitalising stagnant corporations. The huge profits made in the process led many shareholders to believe that they were being cheated out of their hard earned wealth.

Critics have contended that these buy-outs were unethical and immoral, because there was an inevitable breach of fiduciary duty arising from from the irreconcilable conflicts of interest which emerge during the buy-out process. The management cannot act impartially whilst acting both as fiduciary and as principal. Furthermore, the management are the ultimate

¹⁵⁰ See section 11(d) of the Prescription Act No 68 of 1969, as amended.

¹⁵¹ See note 136.

¹⁵² See section 302(4) of the Companies Act (No.61 of 1973), as amended.

insiders and as such have an almost insurmountable informational advantage over the shareholders and other potential investors. For these reasons they say Management Buy-Outs should be either prohibited or heavily regulated.

There can be no disagreement with the critics that conflicts of interest and opportunities for insider trading may arise during the buy-out process. However, their suggestion that buy-outs should be prohibited should not seriously be entertained. Neither commerce nor our Company Law (both common and statute) are strangers to conflicts of interest or insider trading. They have chosen, rather than prohibiting transactions involving conflicts of interest, to impose strict rules of disclosure to solve or prevent many of the real or potential disputes which may arise.

It is submitted that in South Africa, virtually all the criticisms levelled at Management Buy-Outs by the critics can effectively be dealt with by a rigorous application of the strengthened regulations relating to insider trading¹⁵³, the surfeit of disclosure provisions in the Companies Act¹⁵⁴, the disclosures required by the Johannesburg Stock Exchange¹⁵⁵ and Securities Regulation Panel¹⁵⁶ and the protections offered by the common law¹⁵⁷.

The only area that appears to have been neglected is that of disclosure after the buy-out. It is recommended that a new section be promulgated in the Companies Act or included in the Code to remedy this hiatus. The

¹⁵³ See 4.4 above.

¹⁵⁴ See footnotes 126 and 127.

¹⁵⁵ See Rule 18 in section of the Listings Requirements of the JSE.

¹⁵⁶ See Rule 17 of the Securities Regulation Code on Take-Overs.

¹⁵⁷ See Robinson v Randfontein Estates Gold Mining Co Ltd, 1921 AD 139; Regal (Hastings) Limited v Gulliver [1967] 2AC 134, [1942] All E R 378; Pretorius v Natal South Sea Investment Trust Ltd 1963 (3) SA 410 (W) and Bayer South Africa (Pty) Ltd v Frost 1991 (4) SA 559 (A).

Securities Regulation Panel must be permitted to call on any company, which has been subjected to a "going private" buy-out, regardless of the structure used, for a period of three years, to disclose their audited financial statements and any other information the Panel may reasonably request.

The financial and any other information is to be kept confidential and to be used by the Panel only to ascertain whether or not there had been any non-disclosure during the buy-out period. If it is found that inordinately high profits are being made within this period, a thorough investigation must then be launched and the directors called upon to answer questions in this regard. If the Panel is of the opinion that there had been material non-disclosure during the buy-out period, the Panel should be permitted, after having obtained a court order to this effect, to seize any documents they may deem necessary to show the extent to which the directors have profited from the non-disclosure. This will permit the Panel to prepare a criminal case under the insider trading provisions¹⁵⁸ where shares had been purchased whilst the directors were in possession of unpublished price sensitive information¹⁵⁹. The problem of course is what to do if assets as opposed to shares were purchased. This purchase of assets on the basis of unpublished information is clearly not an offence in terms of the Act¹⁶⁰. It is suggested that perhaps in the case of "going private" transaction involving the sale of assets, Rule 17¹⁶¹ of the Securities Regulation Code on Take-Overs should include a provision which makes it an offence not to disclose any material information, which could effect the price of the assets during a buy-out. A further provision should then be enacted permitting aggrieved shareholders an action to recover any losses they may have

¹⁵⁸ In terms section 440F(1) of the Companies Act (No.61 of 1973), as amended.

¹⁵⁹ See footnote 114 for the definition of unpublished price sensitive information.

¹⁶⁰ The section clearly speaks of a "security".

¹⁶¹ Rule 17 makes provision for the disclosure to the independent directors of the offeree company of all information furnished to the offeror's providers of finance.

suffered as a result of the non-disclosure¹⁶².

It is submitted that the enactment of the above or similar provisions will more than satisfy any of the criticisms leveled at Management Buy-Outs which have not already been addressed by existing legislation and common law.

-oo00oo-

¹⁶² This provision would be much the same as the civil remedy contained in section 440F(4)(a) of the Companies Act (No.61 of 1973), as amended.

Bibliography

1. Reference Books

- Anonymous : Management Buy-Outs, 3 December 1986
Finance Week.
- Anonymous : Management Buy-Outs, 27 March 1987
Financial Mail Supplement.
- Anonymous : Merchant Bankers Association
Working Paper on Valuations
21 February 1992 Ref No:8062/MA 06.
- Anonymous : S A Law Commission:
Preferences on insolvency
(Working Paper I (1982)).
- Anonymous : The Lucrative World of Management
Buy-Outs - (Dec 1986) Euromoney Supplement.
- Britzius O : South African Company
Secretarial Practice (Johannesburg, 1988).
- Blackman M S : The Fiduciary Doctrine and its
Application to Directors of Companies
(Unpublished PhD-Thesis,
University of Cape Town, 1970).
- Blackstone L & Franks D : Guide to Management Buyouts 1986-87
(London, 1986).
- Campbell I : Canadian Valuation Service
(Toronto, 1991).
- Cilliers H S and
Benade M L : Company Law (4ed, Durban, 1982).
- Cilliers H S and
Benade M L : Corporate Law (Durban, 1987).
- Clark R C : Corporate Law (Boston 1986).
- Clutterbuck D and Devine M : Management Buyouts (London, 1987).
- Coaker J F and Zeffertt D T : Wille and Millin: Mercantile Law of South Africa

(18ed, Johannesburg, 1984).

- Copeland T : Valuation : Measuring and Managing the Value of Companies (New York, 1990).
- Corkery J F : Director's Powers and Duties, (Melbourne, 1987).
- De la Rey E : Mars: The Law of Insolvency in South Africa (8ed, Johannesburg, 1988).
- Dillon C : The Non-Executive Director in Modern Company Law (Unpublished LLM Thesis, University of South Africa, 1986).
- Du Plessis J J : Maatskappyregtelike Grondslae van die Regsposisie van Direkteure en Besturende Direkteure (Unpublished LLD Thesis, University of the Orange Free State, 1990).
- Farrar J H, Furey N and B Hannigan : Farrar's Company Law (2ed, London, 1988) .
- Franks J A : The Company Director and the Law, (5ed, London, 1986).
- Gardner D C : Leverage and Management Buy-Outs Work Book (London, 1990).
- Gower L C B : Gower's Principles of Modern Company Law (4ed, London, 1979).
- Joubert W A(Ed) : Vol 4 Companies The Law of South Africa (Johannesburg,1982 including the cummalative updates).
- Krieger I : Management Buyouts (London, 1990).
- Mayson S W : Mayson, French and Ryan on Company Law (London, 1988).
- McLachlan S : The National Freight Buy-out (London, 1983).
- Meskin P M : Henochsberg on the Companies Act, (4ed, Durban, 1985).

- Meskin P and J A K Kunst : Insolvency Law (Durban, 1990).
- Mitchell L R : Insider Dealing and Directors Fiduciary Duties (2ed, London, 1989).
- Naude' S J : Die Regsposisie van die Maatskappydirekteur Met Besondere verwysing na die Interne Maaatskapyverband (Unpublished LLD Thesis, University of South Africa, 1969).
- Ormerod J and Burns I : Raising Venture Capital in the UK (London, 1988).
- Pennington R R : Pennington's Company Law (6ed, London, 1990).
- Pretorius J T : Aanspreeklikheid van die Maatskappy-Ouditeure tenoor derdes op grond van Wanvoorstelling van Finansiële State (Published Thesis, R A U, 1985).
- Pretorius J T,
Delport P A,
Havenga M and
Vermaas L : Hahlo's South African Company Law Through the Cases (5ed Johannesburg, 1991).
- Rider B A K : Insider Trading (London, 1983).
- Schoeman T : Guide to the Companies Act and Regulations (Johannesburg, 1984).
- Shepherd J C : The law of fiduciaries, (Toronto, 1981).
- Shrand D : The Law and Practice of Insolvency, Winding-up of Companies and Judicial Management (Johannesburg, 1977).
- Suter J : The Regulation of Insider Dealing in Britain (London, 1989).
- Wood P R : The Law of Subordinated Debt (London, 1990).
- Wright M, Robbie K
and Coyne J : Flotations of Management Buy-Outs (Nottingham, 1987).
- Wright M and Coyne J : Management Buyouts (London, 1986).

Yago G

: Junk Bonds: How High Yield Securities
Restructured America, (New York, 1991).

2. Articles

- Anonymous : 'Maxwell and MacMillan: Forms of Defence' (1989) 311 The Economist 88.
- Anonymous : 'British Management Buy-Outs - Shareholders
Need to be told Enough' (1989) 311 The Economist
11.
- Anonymous : 'Management Buy-Outs in Europe: On a Slow
Boat' 3 Jan 1987 The Economist 57.
- Anonymous : 'Management buy-outs: Owner Occupiers'
(1982) 285 The Economist 80.
- Anonymous : 'S 38 Financial Assistance-The AD Judgement
in the UDC Case' (1979) SACLJ F-1 to F-17.
- Anonymous : 'S 38 Financial Assistance by Dividend
Declaration' (1979) SACLJ F-17 to F-26.
- Birley S : 'Success and Failure in Management Buy-Outs'
(1984) 17 Long Range Planning 32.
- Brooke R : 'Management Buy-Outs give Industry a New
Lease of Life'-(1984) March/April Industrial
Management and Data Systems 6.
- Brooks P E J : Section 228 of the Companies Act (1987) 50
THRHR 226.
- Bruner R F and Paine S L : 'Management Buy-Outs and Managerial
Review Ethics'-(1988) 30 California Management
89.
- Clarke K : 'Managing the Deal' The Finance Week 200
Supplement (19-25 March 1992) 220.
- Cookson C R and : 'Twentieth Century Auditors:
McQuoid-Mason D J Watchdogs, Bloodhounds or Crossbreeds?'
1975 Natal University LR 164.
- Dalle P F : 'Opportunities for Banks in Leveraged
Buy-Outs' (1985) 168 Bankers Magazine 39.
- Dalton D R : 'The Ubiquitous Leveraged Buy-Out (LBO):
Management Buy-Out or Management

Sell-Out?' (1989) 32 Business Horizons 36.

- Davidson K M : 'Another Look at LBO's ' (1988) 9 Journal of Business Strategy 44.
- Davidson S : 'Insider Trading: A reply to Brian Kantor' (1991) 21 Businessman's Law 94.
- De Angelo L E : Accounting Numbers as Market Valuation Substitutes: A Study of Management Buy-Outs of Public Stockholders (1986) 61 Accounting Review 400.
- De Angelo L and H : 'Management Buy-Outs of Publicly traded Corporations' (1987) 33 Financial Analysts Journal 38.
- Feinberg P : 'The Price of Industry' (1990) 19 Businessman's Law 129.
- Ferguson A : 'Buy-Out Get Rich' Oct 1987 Management Today 74.
- Fishbein M : 'Valuation-an Ozymandian Task' July (1988) Corporate Finance 37.
- Fredman M G : Financial Assistance after Lipschitz (1983) 12 Businessmans Law 138.
- Fredman M G : 'Financial Assistance II' (1983) 12 Businessmans Law 183.
- Fredman M G : 'Financial Assistance II' (1983) 12 Businessmans Law 183.
- Fredman M G : 'Financial Assistance III' (1983) 13 Businessmans Law 25.
- Fredman M G : 'Financial Assistance IV' (1983) 13 Businessmans Law 50.
- Fromson B D : 'The Last Days of Drexel Burnam' (21 May 1990) Fortune 90.
- Green S : 'The Incentive Effects and Control in Management Buy-Outs' (1988) 21 Long Range Planning 26.

- Hecht L : 'Managers who Succeed as Bosses' (1986) Euromoney-Special Survey: The Lucrative World of Management Buyouts 38.
- Hecht L : 'Message in Gibson Greeting Cards' (1986) Euromoney-Special Survey: The Lucrative World of Management Buyouts 35.
- Hite G L : 'Management Buy-Outs of Divisions and Shareholder Wealth' (1989) 44 Journal of Finance 953.
- Jooste R : 'Insider Trading in South Africa' (1991) 107 SALJ 603.
- Jooste R : 'Insider Trading' (1991) 20 Businessman's Law 248.
- Kallen B : 'If You're Smart Buy It Yourself' (1987) 139 Forbes 220.
- Kantor B : 'In Support of Insider Trading' (1991) 20 Businessman's Law 167.
- Katz M : 'How to optimise the tax, accounting and legal issues in a Management Buyout' Management Buyouts, Leveraged Acquisitions and the Financial Entrepreneur 3 August 1989 FKV Conference 50.
- Koven G H and Rafferty C : 'Structuring and Financing an LBO: A Conceptual Approach' Buyouts: Directory of Financing Sources 5ed (1989) 27.
- Kripke H : 'The Myth of the Informed Layman' (1973) 28 The Business Lawyer 631.
- Larkin M : 'Financial Assistance for the Acquisition of Shares' (1981) 11 Businessmans Law 5.
- Latter C : 'Panel MBO Changes-Conflicts of Interest' Jan 1990 FT Mergers and Acquisitions XXVIII.
- Lipper A : 'LBO's Based on Insider Information' (1987) Venture 7.
- Little B : 'The Conscience of Wall Street' 22 June 1989 - Barrons 80.

- Lee P : 'How to be a Buyer-Outer' Dec 1988, Euromoney 65.
- Lowenstein L : 'No More Cozy Management Buy-Outs' (1986) 64 Harvard Business Review 147.
- Maupin R J and Label W A : 'Profiting from a Management Buy-Out' (1987) 68 Management Accounting 32.
- Maupin R J : 'Financial and Stock Market Variables as Predators of Management Buy-Outs' (1987) 8 Strategic Management Journal 319.
- Pozdena R : 'Takeovers and Junk bonds' The Best of Buyouts (1982-1987) 239.
- Quickel S : 'Warnings Fail to Dim LBO Dazzle' (1986) Euromoney Survey: The Lucrative world of Management Buy-Outs 25.
- Randhawa H : 'PIK: A Way To Relieve LBO Concerns' (1990) 15 Accountancy 100.
- Ribbens D S : 'Disposal of the undertaking or whole or greater part of the assets of the company' (1976) 39 THRHR 162.
- Rider B A K : 'The Regulation of Insider Trading in the Republic of South Africa' (1977) 94 SALJ 437.
- Roux A : 'The Buy-Out Scene in South Africa' Management Buyouts, Leveraged Acquisitions and the Financial Entrepreneur 3 August 1989 FKV Conference Transcripts 3.
- Ruffel C : 'Funds Galore for LBO Prospects' (1986) Euromoney-Special Survey: The Lucrative World of Management Buyouts 3.
- Schreiner O : 'The Shareholders' Derivative Action-A Comparative Study of Procedures' (1979) 96 SALJ 203.
- Schwarz M and Weinstein E A : 'So you want to do Leveraged Buy-Out' (1989) 10 Journal of Business Strategy 10.
- Sealy L : 'The Disclosure Philosophy and Company Law Reform' (1981) 2 The Company Lawyer 51.

- Seymore A and Maguire J : 'Leverage: The Opportunities for Industry' (1986) Euromoney-Special Survey: The Lucrative World of Management Buyouts 32.
- Sher J L : 'The Rights of Preference Shareholders: A Re-Examination' (1983) 7 SACLJ 87.
- Stein B J : 'Dear Mr Ruder Your View of Management LBO's is Simply Dead Wrong' 23 Jan 1989 Barrons 44.
- Stein B J : 'Going Private is Unethical' 11 November 1985 Fortune 137.
- Thompson D N : 'Buy-Outs and Buy-Ins: Europes 1992 Shows the Big Way for Free Trade' (1989) 53 Business Quarterly 42.
- Upton R : 'Britains Buy-Out Boom' (1984) 16 Personnel Management 22.
- Volpe P L : 'The Evolving Duties of Company Directors' (1986) 15 Speculum Juris 108.
- White G : 'The Making of an MBO' (1986) 98 Accountancy 95.
- Wiley C : '2 Investors Halt Buy-Out' (1988) 16 Pensions and Investment Age 1.
- Whistler J : 'Avoiding the Pitfalls' The European Buy-Out Directory 1992 183.
- Wright M : 'Management Buy-Outs in Britain - A Monograph' (1987) 20 Long Range Planning 38.

Wright M

: 'Managing Management Buy-Outs Lessons for
would be Entrepreneurs' (1988) 26
Management Decisions 48.

3. Case Law

3.1 South Africa

Atlas Organic Fertilisers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd 1981 (2) SA 173 (T).

Bayer South Africa (Pty) Ltd v Frost 1991 (4) SA 559 (A).

Bellairs v Hodnett 1978 (1) SA 1109 (A).

Brian St Clair Cooper N.O. and others v The Master of the Supreme Court (OFS) and another (AD) unreported.

Cronje NO v Stone en 'n ander 1985 (3) SA 597.

Dadoo v Krugersdorp Municipal Council 1920 AD 530.

Donaldson Investments (Pty) Ltd v Anglo- Transvaal Collieries Ltd 1979 (3) SA 713; 1980 (4) SA 204 (T); 1983 (3) SA 93 (A).

Dublin v Diner 1964 (1) SA 799 (D).

Evrard v Ross 1977 2 SA 311 (D).

Estate Kootcher v Commissioner for Inland Revenue (1941) AD 256.

Estate Milne v Donohoe Investments (Pty) Ltd 1967 (2) SA 359 (A).

Ex Prte Betty: In re First Mutual Investment Trust Ltd 1974 (1) SA 127 (W).

Ex Parte de Villiers NNO: In Re Carbon Developments (Pty) Limited (in Liquidation) 1992 (2) SA 95.

Ex Parte Macey's Stores Ltd 1983 (2) SA 657 (Z).

Fisheries Development Corporation of SA Ltd v Jorgenson 1980 (4) SA 156 (W).

Gradwell v Rostra Printers 1959 (4) SA 419 (A).

Lind v Lefdal's Pianos Ltd (in Liquidation) and Others 1929 TPD 241.

Lipschitz v UDC Bank 1979 (1) SA 789 (A).

Lipschitz v Wolpert 1977 (2) SA 732 (A).

Novick v Comair Holdings Limited 1979 (2) 116 (W).

Pretorius v Natal South Sea Investment Trust Ltd 1963 (3) SA 410 (W).

R v Mall 1959 (4) SA 607 (N).

Robinson v Randfontein Estates Gold Mining Company Ltd 1921 AD 168.

Sibex Construction (SA) (Pty) Ltd v Injectaseal CC 1988 (2) SA 54 (T).

S v Vandenberg 1979 (1) SA 208 (D).

Tonkwane Sawmill Co Ltd v Filmalter 1975 (2) SA 453 (W).

Zentland Holdings (Pty) Ltd v Saambou Nasionale Bouvereeniging 1979 (4) SA 574 (C).

3.2 English

Aberdeen Railway Company v Blaikie Bros 1854 1 Macq 461 at 471 - 472, (1954) 2 All E.R. Rep. 1281.

Allen v Hyatt (1914) 30 TLR 444.

Boardman v Phipps (1966) 3 All ER 721; (1967) 2 AC 46.

Foss v Harbottle (1843) 2 Hare 461, 67 ER 189.

H L Bolton (Engineering) Co Ltd v T J Graham & Sons Ltd (1956) All E.R. Rep 624.

Jones v Jones (1971) All E R 676.

Lagunas Nitrate Co v Lagunas Syndicate (1899) 2 Ch 392.

Lee v Lee's Air Farming Ltd (1960) All E.R. Rep. 420; Privy Council (1961) AC 12.

Parke v Daily News Ltd (1962) 2 All E.R. 929.

Percival v Wright (1902) 2 Ch 421.

Regal (Hastings) Limited vs Gulliver (1942) 1 All ER 378; (1967) 2AC 134.

3.3 Other

Canadian Aero Services Ltd v O'Malley (1974) 40 DLR (3d) 371
(SCC).

Pacific Acceptance Corporation Ltd v Forsyth (1970) 92 WN (NSW)
29.

4. Legislation and Regulations

Companies Act (No 61 of 1973), as amended.

Companies Amendment Act (No 78 of 1989).

Companies Amendment Act (No 69 of 1990).

Financial Markets Control Act, 1989, (Act No 55 of 1989).

Listing Requirements of the Johannesburg Stock Exchange.

London City Code on Take-overs and Mergers.

Notarial Bonds (Natal) Act 18 of 1932.

Prescription Act No 68 of 1969, as amended.

South African Securities Regulation Code on Take-overs and Mergers.

United Kingdom Companies Act 1985.