

REMEDIES FOR DISSENTING SHAREHOLDERS: A COMPARISON OF THE
CURRENT OPTION OF PERSONAL ACTION AND THE PROPOSED APPRAISAL
REMEDY UNDER THE COMPANIES BILL OF 2008

by

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I declare that
REMEDIES FOR DISSENTING SHAREHOLDERS: A COMPARISON OF THE
CURRENT OPTION OF PERSONAL ACTION AND THE PROPOSED APPRAISAL
REMEDY UNDER THE COMPANIES BILL OF 2008 is my own work and that all the
sources that I have used or quoted have been indicated and acknowledged by means of
complete references.

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SUMMARY

Title: Remedies for Dissenting Shareholders: A Comparison of the Current Option of Personal Action and the Proposed Appraisal Remedy under the Companies Bill of 2008.

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Degree: Master of Laws with Specialization in Corporate Law.

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Summary: The Companies Bill B61-2008 proposes to introduce appraisal rights into South African law. Appraisal entitles a shareholder to demand payment from the corporate issuer of his shares at a fair cash value in certain instances where major transactions which would change the company's direction have been proposed. It allows a cash exit rather than being coerced into supporting the majority's decision. Arriving at a fair share value is a challenge to appraisal. Presently, under the Personal action, a shareholder who opines that the company's act or omission is unfairly prejudicial or that its affairs are conducted in an unfairly prejudicial manner, may apply to court for an appropriate order. It enables the minority to challenge the majority's decision. Both remedies will be available to dissenting shareholders under the new dispensation and a shareholder must decide which remedy best suits his purposes. Appraisal should be seen as a last resort.

Key terms: Dissenting shareholders; Appraisal rights; Personal action; Companies Bill; Remedies; Section 252; Fair value; Minority protection; Unfairly prejudicial unjust or inequitable; Minority buy-out.

DEDICATION.

This work is dedicated to God Almighty; my mother, Mrs. Bisi Toriola; and the memory of my father, Mr. Remi Toriola.

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TABLE OF CONTENTS

PAGE

1. Introduction and Problem Statement.2

2. Other Possible Remedies.4

3. Personal Action under the Companies Act 61 of 1973.7

4. Personal Action under Clause 163 of the Companies Bill.12

5. Appraisal Rights under Clause 164 of the Companies Bill.13

6. An Examination of Appraisal Rights in the USA.16

7. An Examination of Appraisal Rights in New Zealand19

8. Valuation of Shares – Arriving at a Fair Value. 21

9. A Comparison of Section 252 and Clause 164.25

10. Merits and Demerits of Appraisal.27

11. Merits and Demerits of Personal Action.29

12. Conclusions and Recommendation.31

Bibliography32

1. INTRODUCTION AND PROBLEM STATEMENT.

In company law, the business of the company is generally conducted based on the votes of the majority of shareholders in that company. Naturally, in some instances, their conduct may be to the detriment of minority shareholders in the company. It is therefore well in order for any company legislation to anticipate such situations and to make provision in one form or the other, to give respite to minority shareholders.

The respite currently available to individual minority shareholders in South African company law is the personal action. A personal action may be instituted by an aggrieved member against the company for the wrong done to that member or a group of members. The personal action is presently enshrined in section 252 of the Companies Act.¹ By virtue of section 252(1), any member of a company may make an application to the court for an appropriate order if he believes that an act or omission of the company is unfairly prejudicial, unjust or inequitable to him or some members of the company or that the company's affairs are being conducted in a manner which is unfairly prejudicial, unjust or inequitable to them. Further specific circumstances under which such a member may make an application are set out in section 252(2), which will be discussed below.²

The aim of a personal action is to protect minority shareholders who otherwise would be left completely at the mercy of the decisions or failure to act of the majority. It enables an aggrieved member to in certain instances seek redress against the decision-makers of the company in his own interest or in the interest of a group of members to which he belongs. The availability of this remedy will not only serve to reverse some decisions already taken but could also serve as a deterrent to the majority.

Of particular interest to this study is appraisal, which is another remedy available to minority shareholders in a company. Although currently not available in South African company law, appraisal rights have been in existence in other jurisdictions like the United States of America and New Zealand. Appraisal, also known as dissenters rights, share-purchase remedy, minority buy-out or minority buy-back, could be defined as any

¹ Act 61 of 1973, hereafter referred to as "the Companies Act" or "the Act".

² See paragraph 3.0.

provision in company legislation giving an aggrieved shareholder the right to demand payment from the corporate issuer of his shares at their fair cash value.³

It would appear that appraisal rights have been in existence long before the enactment of a set of rules expressly providing for appraisal.⁴ The courts in some earlier cases allowed aggrieved shareholders to sue for the value of their shares where the majority had sold all of the corporation's assets, or merged it with another corporation, or where the majority had exceeded their lawful powers, on the grounds that their interest had been converted. However, the manner of resolving these disputes was anything but satisfactory to either party i.e. the company on one side and the aggrieved shareholder on the other. It seemed safer for the company to compromise quietly than risk having the transaction set aside or enjoined after costly preparation. Again the shareholder instituted the action at great cost and the outcome was mostly uncertain. It was in order to find a balance between these opposing sides that appraisal statutes were enacted.⁵

There are three basic justifications for the introduction of the remedy.⁶ They are:

- i. to compensate the minority for the loss of their veto power;
- ii. to enable a cash exit instead of being coerced to take up stock in a new entity; and,
- iii. to protect the majority by expediting corporate transactions.

The Companies Act is currently under review and a new Bill⁷ has been passed by Parliament and is awaiting the President's assent. Once passed it is expected to come into operation in South Africa in 2010. The aim of the Bill is to improve company legislation in South Africa and a major feature is the inclusion of appraisal rights for dissenting shareholders. This remedy is enshrined in clause 164 of the Bill.

³ See Paine S.J. "Achieving the Proper Remedy for a Dissenting Shareholder in Today's Economy: *Yuspeh v Koch*" Winter 2005 (vol. 65) no.2 *Louisiana Law Review* 911.

⁴ See Lattin N.D. "Remedies for Dissenting Stockholders under Appraisal Statutes" (1931) vol. XLV no. 2 *Harvard Law Review* 233 at 234.

⁵ *Ibid* at 236-237.

⁶ See Hagan K. J. "*First Western Bank Wall v Olsen*: An interpretation of 'Fair Value' for Minority Shares as Found within the South Dakota Dissenter's Rights Statutes" (2003) Vol. 48 *South Dakota Law Review* 83 at 89-90.

⁷ Bill B61D of 2008, hereafter referred to as "the Companies Bill" or "the Bill".

It is pertinent to note that the personal action remains preserved under the Bill by virtue of clause 163. Clause 163 provides for a personal action similar to, but much wider in scope than that currently found in section 252 of the Companies Act. This shall be further dealt with in the course of this study.⁸

The effect of the introduction of clause 164 is that in addition to the personal action, minority shareholders in South Africa will now have the opportunity to offer up their shareholding for sale to the company and opt out of the business venture where they are of the opinion that their interests will not be furthered or will be otherwise affected by an act or omission of the majority.

Clause 164 sets out in detail the circumstances under which a member may demand appraisal and the dynamics governing this remedy. The proposed appraisal clause will be analysed in the course of this study.⁹

The object of this study is to make a comparison between the personal action under section 252 of the Companies Act and the proposed appraisal rights under clause 164 of the Companies Bill, with a view to determining the plausible effects which the introduction of appraisal will have on company law and practice in South Africa.

2. OTHER POSSIBLE REMEDIES.

As stated earlier, the personal action and appraisal form the focus of this research. It must be noted however that there are a number of other actions which members may resort to and it is in order to briefly highlight these.

a). Derivative action

The common law derivative action is instituted in respect of unratifiable wrongs by a member acting on behalf of all shareholders, except the wrongdoers, where the company cannot or does not act against them.¹⁰ In such a situation, the plaintiff must join the company as nominal defendant, making it a party to the proceedings; hence, any order

⁸ See paragraph 4.0.

⁹ See paragraph 5.0.

¹⁰ See Cilliers H. S., Benade M. L., Henning J. J., Du Plessis J. J., Delpont P. A., De Koker L. & Pretorius J. T. *Corporate Law* 3rd edition Butterworths 2000 at 300. et al *supra* at 302-303.

made becomes applicable to it. It has been submitted that the procedure to be followed under common law is uncertain in South Africa.¹¹ Further militating against the derivative action at common law is the fact that the member initiating the proceedings under common law bears the cost of litigation and if successful, the benefits thereof accrue to the company, not to him personally.¹²

The statutory derivative action is enshrined in section 266 of the Companies Act. It may be instituted by a member against a director or other officer¹³ of the company if the company has suffered damages or loss, or has been deprived of any benefit as a result of any wrong, breach of trust or breach of faith committed by the said wrongdoers.¹⁴ The member must first serve a written notice on the company calling on it to initiate such proceedings within one month from the date of service and that failing which, he shall initiate the proceedings.¹⁵ Should the company fail to initiate the proceedings, the member may make an application to the court for an order appointing a curator *ad litem* to institute and conduct the proceedings on behalf of the company, which order the court may grant if it is satisfied such order could be granted.¹⁶ On the return day, the court may discharge the provisional order, or confirm the appointment of the curator *ad litem* and issue the appropriate directions as it may deem fit.¹⁷

The basis of instituting this type of action is different from that of a personal action or appraisal. This type of action may be instituted if it can be proved that the company has suffered damages or loss or has been deprived of any benefit owing to a wrong, breach of trust or faith committed by a past or current director or officer and it failed to institute proceedings to seek redress. Here, unlike in a personal action or appraisal, a member need not be personally involved in litigation but need simply initiate proceedings for the appointment of a provisional curator who reports his findings to the court and the court if satisfied, appoints a curator *ad litem* who then institutes proceedings against the said wrongdoers.

¹¹ *Ibid* at 305.

¹² *Ibid* at 305.

¹³ Past or present.

¹⁴ See section 266(1).

¹⁵ See section 266(2)(a).

¹⁶ See section 266(2)(b).

¹⁷ See section 266(4).

b). Private action

Aptly named by Cilliers et al¹⁸, this remedy is available to a member in his private capacity for the enforcement of rights in his private capacity and not as a member. For example, a member may also be an officer of the company and thus, the need may arise to enforce his fees or claim damages stemming from a wrong done to him personally. This clearly differs from a personal action where a member may make the application in his capacity as a member of the company on his own behalf as well as on behalf of other members of the company. It also differs from appraisal in that an application for appraisal stems from an individual's membership of a company.

c). Application for Inspection of the Company's Affairs.

Section 257 of the Act empowers the Minister on the application of members, to appoint an inspector to investigate affairs of a company and to report thereon. The application may be made by not less than one hundred members or members holding not less than one-twentieth of issued shares, in the case of a company with share capital, and in the case of a company without share capital, by not less than one-tenth of the number of persons on the register of members. The Minister may then make an application to the court for an appropriate order, based on the inspector's report.¹⁹

3. THE PERSONAL ACTION UNDER THE COMPANIES ACT 61 OF 1973.

The remedy presently available to individual dissenting shareholders in South Africa is the personal action and it is provided for by section 252 of the Companies Act and at common law. I focus on the statutory personal action.

An individual member of a company may make an application to the court for an appropriate order where such member is of the opinion that a particular act or omission of the company is unfairly prejudicial, unjust or inequitable, or that the affairs of the company are being conducted in a manner which is unfairly prejudicial, unjust or

¹⁸ *Ibid* at 299, to avoid confusing it with either personal action or derivative action.

¹⁹ See section 262 (1).

inequitable to him or to some members of the company.²⁰ This first part of this statement is self-explanatory. An application may be filed not only on the basis of a specific act, but also as a result of the inactivity or failure to act of the company. An applicant must be a formally registered member of the company. Thus in *Lourenco v Ferela (Pty) Ltd (No. 1)*²¹ where the applicants had inherited shares but had not yet received the shares and had not been formally registered as members, the court held that they had no *locus standi* to make the application for relief.

Section 252(2) also refers to certain specific circumstances. These are where the act in question relates to the following:

- a). alteration of the memorandum of the company;
- b). reduction of the company's share capital;
- c). variation of rights attached to shares; and
- d). conversion of a private company into a public company and vice versa under section 22.

In the event of acts specifically listed under subsection 2, the application must be made within six weeks of the date on which the said special resolution was passed²².

Section 252(3) empowers the court to make such order as it deems fit. Such an order may be for regulating the future conduct of the company's affairs. In *Heckmair v Beton & Sandstein Industrieë (Pty) Ltd*²³, it was reaffirmed that the court can make an order for the future regulation of the management of the company's affairs. The order may also be for the purchase of a member's shares by other members or by the company itself, in which case an order need be made also for the reduction of the company's capital or otherwise.²⁴

Where the court's order is for the alteration of, or addition to the memorandum or articles of the company, by virtue of section 252(4)(a), such alteration or addition will subject to

²⁰ See section 252(1).

²¹ 1998 (3) SA 281 (T).

²² See section 252(2).

²³ 1980 (1) SA 350 (SWA).

²⁴ See section 252(3).

subsection (b), have effect as if it was duly made by special resolution of the company. Section 252(4)(b) provides that the company shall have no powers whatsoever except as otherwise provided in the order, to make any alteration in or an addition to its memorandum or articles which is inconsistent with the order made, except with the leave of the court.

Section 252(5) mandates the company to lodge an order which alters or adds to or which grants leave to alter or add to the company's memorandum or articles with the Registrar in the prescribed form within one month of the making thereof, failing which, the company shall be guilty of an offence.

In a nutshell, a minority shareholder may be able to seek relief statutorily against a company if he is able to satisfy the requirements set out in section 252, which relief is completely at the discretion of the court. This discretion is of such a nature that even if it appears to be just and equitable to grant the relief sought, the court still retains an unfettered discretion to grant the relief or to refuse to do so.²⁵ It must be emphasized that section 252 does not in any way abolish the personal action under common law. It is an additional remedy and does not in any way encroach on majority rule.²⁶

It is in order to briefly examine the position under the 1926 Companies Act²⁷ which preceded the 1973 Act. Section 111*bis* of the 1926 Act also provided for the protection of minority shareholders. However, there are notable differences between section 111*bis* and the current section 252. For instance, section 111*bis* provided that the facts must be such as to justify the making of a winding up order on the ground that it is just and equitable for the company to be wound up but that to wind it up however would unfairly prejudice the applicants. Also, under section 111*bis*, it was necessary to show that the affairs of the company were being conducted in a manner which was "oppressive" to some members of the company. The difficulty posed by the latter requirement was not farfetched. It was difficult to fathom exactly what would amount to oppression and it appeared the courts were not always consistent in determining the meaning of oppression.

²⁵ See section 252(3).

²⁶ See Cilliers et al at 314.

²⁷ Act 46 of 1926.

At the introduction of a new companies Act,²⁸ a new section, section 252, was included to provide for members personal remedy. Section 252 was enacted to among other things, mitigate the hardships experienced under section 111*bis*. The requirements of oppression and the facts being those that justify winding up under section 111*bis* were excluded. In place of oppressive conduct, section 252 required “unfairly prejudicial, unjust or inequitable conduct” which appears to have a much wider range of acts than the former. However, it has been submitted²⁹ that the test of unfairness is objective and it is necessary yet again to have a wider interpretation to provide adequate protection for minority shareholder and further³⁰ that an applicant must establish a lack of probity or fair dealing or an obvious departure from the standards of fair dealing, or a violation of the conditions of fair play on which every shareholder may rely; it must be conduct which departs from the accepted standards of fair play, or which amounts to an unfair discrimination against the minority.

What would amount to “unfair”, “unjust”, or “inequitable” is determined by an objective test, and completely at the discretion of the court. In *Barnard v Carl Greaves Brokers (Pty) Ltd*,³¹ the applicant was a shareholder and director of the defendant company. Relations between him and other shareholders deteriorated over time and consequently, he convened a meeting, offering to sell his shares to them. Shortly after the said meeting however, he was served with a notice of intention to institute proceedings for his removal as a director of the company. The applicant was suspended as a director and denied access to the company’s offices, its staff and business connections. The locks to the company’s premises were changed. He was given a notice of meeting shorter than was statutorily required, the agenda of which included a waiver of the shareholders’ agreement, his removal as director and from all official positions within the company. The Applicant also received a demand that he pay a huge amount allegedly due in respect of his loan account in the company’s books, but was denied access to any information to confirm this unsubstantiated claim. He received inadequate notice to appear before a

²⁸ Act 61 of 1973.

²⁹ See Pretorius J. T., Delpont P. A., Havenga M., Vermaas M: *Hahlo’s South African Company Law through the Cases* 6th ed Juta 1999 at 403.

³⁰ *Ibid* at 316.

³¹ 2007 JDR 0047 (C) 2.

disciplinary enquiry and his request for postponement was rejected and was subsequently informed by letter of his dismissal as an employee of the company. The applicant filed amongst other things, an application for the provisional winding up of the defendant and in an amended notice of motion, sought in the alternative, an order directing the other members of the company to purchase his shares, which is an order made under section 252 of the Companies Act. Although the amended notice of motion was not expressly premised on section 252, due to the premise on which the relief sought was based i.e. unfairly prejudicial, unjust or inequitable conduct; the court rightly based the alternate relief sought as an application under section 252. In determining which conduct would be said to be unfair, unjust or inequitable, the court held that it was not enough for the applicant to show that he was unhappy in his relationship with other shareholders and desired to withdraw from the company.³² Rather, it found acts which could come under this description to include the following:³³

- i. excluding a member from the management of the company against his will, in a manner inconsistent with the spirit and provisions of the shareholders' agreement;
- ii the manner in which a shareholders' meeting had been convened on improperly short notice, the business at which, was to remove the applicant as a director of the company;
- iii. the way in which a disciplinary enquiry was convened;
- iv. the company's demand for payment of the applicant's loan account;
- v. the instruction by management of the company's auditor to refuse applicant access to financial information which he reasonably required to confirm his account with the company; and,
- vi. the manner in which applicant's peaceful possession of his office at the company's premises was disrupted.

³² See page 26, para 45.

³³ See pages 26-27, para 45.

In the above case, it was the company's contention that the applicant was personally responsible for the breakdown in relations between the parties, having failed to apply himself to his duties. The court found this argument unconvincing because there was previously no evidence of any complaint against the applicant prior to his expressing the desire to withdraw from the company. Rather, he had been awarded a salary increase.

On what would be a standard case of unjust, inequitable or unfair treatment, the court further quoted Lord Hoffman in *O'Neill and Another v Phillips and Others*,³⁴ which was an appeal before the House of Lords against an application under the English equivalent of section 252³⁵ thus:

"... shareholders have entered into association upon the understanding that each of them who has ventured his capital will also participate in the management of the company. In such a case it will usually be considered unjust, inequitable or unfair for a majority to use their voting power to exclude a member from participation in the management without giving him the opportunity to remove his capital upon reasonable terms."

In a nutshell, it would be unjust, inequitable or unfair where the majority in a company deliberately wields its voting power to prevent the minority from taking part in its management and yet, does not allow him to have his contribution back.

In *Steyl v Du Plessis and Others*,³⁶ the court reaffirmed the position of the law that the court's order should be one which is aimed at bringing to an end the act or omission complained of. In order to achieve this aim, the order of the court should bear directly or indirectly on the perpetrator of the oppression.

It is submitted at this juncture that an act or omission which may qualify as adversely affecting a shareholder's right may not necessarily be unfair, unjust or inequitable, such that it could be the basis of an application under section 252. The decision of the majority ordinarily prevails, as long as it can be established that such act is not illegal. Thus, a lawful and honest decision of the majority which results in a decrease in the value of the company's shares, for example, is an act adversely affecting the member's shareholding.

³⁴ (1999) 1 WLR 1092; (1999) 2 All ER 961.

³⁵ Section 459 of the English Companies Act 1985 (Chapter 6 of 1985). This Act has however been replaced by the Companies Act 2006 (Chapter 46 of 2006).

³⁶ 2004 JDR 0594 (C) 2.

However, it may not necessarily be classified as unfair, unjust or inequitable. This is where the discretion of the court will come into play, taking into consideration all the circumstances of the case.

It must be noted that section 252 will not apply to a future act i.e. an act which has not yet been carried out; an act which is still being contemplated. In *Porteus v Kelly*³⁷, the applicant applied to court for an interdict to restrain the respondent from calling a meeting and passing a particular resolution. The court held that something to be done in future, as in the instant case was not yet an act within the ambit of section 252. In the same vein, an act or omission of an officer of the company but which is not an act or omission of the company would also not come under the ambit of section 252³⁸.

Although section 252 (just like its predecessor, section 111*bis*) was designed to protect minority shareholders, the courts have held that a major shareholder could also apply for relief in certain cases³⁹.

4. THE PERSONAL ACTION UNDER CLAUSE 163 OF THE BILL.

The Companies Bill also recognizes and provides for the personal action in clause 163. Clause 163 is similar in form to, but much wider in scope than section 252 of the Act.

In terms of clause 163, a member or director of a company may apply to the court for relief if the company or a related person's act or omission is oppressive, unfairly prejudicial to or unfairly disregards his interests; or the business of the company or a related person is carried on in an oppressive or unfairly prejudicial manner to the applicant's interests; or the powers of the directors, prescribed officers of the company or a related person are exercised in an oppressive or unfairly prejudicial manner to the applicant or unfairly disregards his interests. Just as it obtains under section 252, the court retains the discretion under clause 163 to make any order as it deems fit and clause 163(2) proceeds to list an array of possible orders.

³⁷ 1975 (1) SA 219 (W).

³⁸ See *Kennedy v Micro Design (Pty) Ltd* 1995 (1) Commercial Law Digest 67 (W).

³⁹ See *Benjamin v Elysium Investments (Pty) Ltd* 1960 (3) SA 467 (E).

It is clear from the above that the aim of the Companies Bill is not to exclude the personal action but rather to also afford aggrieved shareholders the option of appraisal if they so wish.

5. APPRAISAL RIGHTS UNDER CLAUSE 164 OF THE COMPANIES BILL.

Clause 164 provides that an aggrieved shareholder may under certain circumstances demand to be paid the fair value for his shares. The circumstances under which a member may invoke clause 164 are:

1. Where a company proposes to amend its Memorandum of Incorporation in any manner adverse to the rights or interests of holders of any class of shares;⁴⁰ or
2. Where it proposes to enter into any of the transactions considered under Clause 112, 113 or 114.⁴¹

At this juncture, it is in order to examine in detail the provisions of clause 164. Clause 164(2) provides that if a company gives notice to shareholders of a meeting to consider adopting a resolution to amend its Memorandum of Incorporation in any manner which is adverse to the rights or interests of any class of shareholders⁴², or to enter into a transaction contemplated in clauses 112, 113 or 114, the company must include a statement informing shareholders of their rights under the clause. These rights are entrenched in clause 164(3) and (5).

An aggrieved member is entitled to send a written notice to the company objecting to the proposed resolution before its adoption.⁴³ In the event that the company goes ahead to adopt the resolution however, every shareholder who filed an objection and who did not withdraw it or who voted in support of it, is entitled to receive a notice to that effect within ten business days.⁴⁴ Clause 164(5) entitles dissenting shareholders who meet conditions stipulated therein to demand for payment of the fair value for their shares.

⁴⁰ Clause 164(2)(a).

⁴¹ Clause 164(2)(b).

⁴² i.e by altering the preferences, rights, limitations or others terms of class of shares.

⁴³ Clause 164(3).

⁴⁴ Clause 164(5).

In addition to amendment of the company's Memorandum of Incorporation, one of the requirements for appraisal is the company having entered into a transaction contemplated in clauses 112, 113 or 114. These clauses deal with proposals for the disposal of the company's assets or undertaking, proposals for a merger or amalgamation and proposals for scheme of arrangement respectively.

Clause 112 provides for the disposal of all or the greater part of the company's assets or undertaking. A disposal is allowed only if it has been approved by shareholders in fulfillment of clause 115 and the company has satisfied all other requirements therein, to such extent as they are applicable to the disposition.⁴⁵ A resolution under subclause 5 will be effective to the extent that it ratifies a specified transaction.⁴⁶

Clause 113 applies to proposals for merger or amalgamation. The import of this section is that where two or more companies propose to merge or amalgamate, they must enter into an agreement setting out the terms and means effecting the transaction and the agreement must be submitted for consideration at a meeting of shareholders of each company.⁴⁷ Notice of such meeting must be sent to all shareholders of each company.

Clause 114 applies to proposals for a scheme of arrangement. It allows the company's board to propose and implement any arrangement between the company and holders of a class of shares. Arrangement includes a reorganization of its share capital by methods including consolidation of different classes of securities, division of securities into different classes, expropriation of securities from their holders, exchange of securities or a combination of these methods.⁴⁸

The underlying factor in these three instances is that a major decision is about to be taken or has been taken in respect of the company's business and/or a member's shareholding which may substantially affect the shareholder's interest. Clause 164 therefore incorporates the mechanism whereby an aggrieved shareholder has not only the option of a personal action under Clause 163 but also that of appraisal.

⁴⁵ Clause 112(2).

⁴⁶ Clause 112(5).

⁴⁷ Clause 113(4)(b).

⁴⁸ Clause 114.

A shareholder who satisfies the necessary requirements for appraisal under clause 164(5) may make his demand in the form of a written notice to the company within 20 business days after receiving the company's notice under subsection 3⁴⁹, or in the absence of notice, within 20 working days after learning that the said resolution had been adopted.⁵⁰

A shareholder requesting appraisal must give in his demand, his name and address, the number and class of shares over which he dissents and a demand for payment of their fair value.⁵¹

It must be noted that a shareholder who has sent in his demand has no further rights in respect of those shares other than to be paid their fair value, unless the demand is withdrawn before the company could make an offer, or the dissenting shareholder allows the company's offer to lapse,⁵² if the company fails to make an offer and the shareholder withdraws the demand⁵³ or if the company revokes the adopted resolution which gave rise to the shareholder's rights in the first place.⁵⁴ It is logical that should any of these situations occur, there would be no further need of appraisal. Should that be the case, the shareholder's rights would be re-instated without interruption.⁵⁵ Clause 164(11) goes further to set out regulations and time frames to guide all parties.

It is important to note that offers in respect of shares of the same class or series must be made on the same terms.⁵⁶ Also, on accepting an offer, the shareholder must tender the share certificate to the company or its transfer agent; or in the case of uncertificated shares, he must take the necessary steps under clause 53 to transfer them to the company or its transfer agent,⁵⁷ upon which the company must pay the agreed sum within ten working days.⁵⁸ Should the company fail to make an offer, or makes one considered to be inadequate, the aggrieved shareholder may apply to the court to determine a fair value for

⁴⁹ Clause 164(7)(a).

⁵⁰ Clause 164(7)(b).

⁵¹ Clause 164(8).

⁵² Clause 164(9)(a).

⁵³ Clause 164(9)(b).

⁵⁴ Clause 164(9)(c).

⁵⁵ Clause 164(10).

⁵⁶ Clause 164(12)(a).

⁵⁷ Clause 164(13)(a).

⁵⁸ Clause 164(13)(b). An application for a deferral may be made only on the ground that payment would prevent the company from meeting the solvency and liquidity test.

his shares and for an order directing the company to pay the value so determined.⁵⁹ In the event that either party applies to the court, the court has the discretion to join any other person to the suit as a dissenting shareholder, determine a fair value for the shares, appoint appraisers to assist in determining the fair value, allow a reasonable interest rate to accrue to the shareholder or, make an order as to costs.⁶⁰

It must be noted that the fair value for the shares in question must be determined as at the date on which, and the time immediately preceding the adoption of the said resolution⁶¹. Further, where the resolution in dispute was for a merger or amalgamation with other companies and the company at the centre of the dispute has ceased to exist, its obligations automatically become the obligations of the new company formed by the merger or amalgamation⁶².

Should there be reasonable grounds to believe that a company would be unable to pay its debts when due, the company may apply to the court for an order varying its obligations.⁶³ The court may then make a just and equitable order, taking the company's financial standing into consideration and ensure that the lender is paid at the earliest possible date.

A shareholder's tender of shares, demand and the subsequent payment by the company under this clause does not in any way amount to a distribution by the company, nor acquisition of its own shares under clause 48 and is therefore not subject to that clause or application of the solvency and liquidity test by the company under clause 4.⁶⁴

Clause 164 does not apply to a transaction, agreement or offer made pursuant to a business rescue plan that was approved by the shareholders in terms of clause 152.⁶⁵

⁵⁹ Clause 164(14).

⁶⁰ Clause 164(15).

⁶¹ Clause 164(16).

⁶² Clause 164(18).

⁶³ Clause 164(17).

⁶⁴ Clause 164(19).

⁶⁵ Clause 164(1).

6. AN EXAMINATION OF APPRAISAL RIGHTS IN THE USA.

Appraisal rights as a remedy for dissenting shareholders is incorporated into the company law statutes of all states in the United States of America.⁶⁶ Most states formulated their appraisal statutes from the Model Business Corporations Act (MBCA), the scope of its application however varies from one state to the other. For example, application of appraisal is limited mostly to mergers and consolidations in California⁶⁷ and Delaware, where more than half of the largest corporations in America are incorporated.⁶⁸ The most common instances in which appraisal rights are exercised are mergers and consolidations, substantial transfers of assets in some states, dissolutions, certain amendments to corporate articles and some other changes that may arise.⁶⁹

The MBCA was formulated in 1928 and was originally known the Uniform Business Corporation Act. It was renamed the Model Business Corporation Act in 1943. The American Bar Association created its own MBCA in 1950 to act as a guide for all areas of corporate law. The MBCA has been revised on a number of occasions since then. The current version of the revised sections on appraisal was rewritten in 1999⁷⁰, and the latest version of the MBCA was released in 2002.

Although statutorily, appraisal has been in existence for a while, it has only recently come into regular use and this has been attributed in part to the decline in the number of tender offers, the increase in the incidence of mergers and the US Supreme Court's order that shareholders whose voting powers would not affect the outcome of a vote should seek protection in state law remedies e.g. appraisal, rather than proxy rules of the Federal Securities Laws.⁷¹

⁶⁶ Hagan *supra* at 83.

⁶⁷ Vorenberg J. "Exclusiveness of the Dissenting Shareholder's Appraisal Right (1964) no. 7 *Harvard Law Review* 1189 at 1207.

⁶⁸ Hagan *supra* at 93.

⁶⁹ Vorenberg *supra* at 1189.

⁷⁰ Aiken M. "A minority shareholder's rights in dissension – how does Delaware do it and what can Louisiana learn?" (2004) vol. 50 *Loyola Law Review* 231 at 236.

⁷¹ Hagan *supra* at 91.

The relevant section of the MBCA on appraisal is section 13.02(a). It provides that a shareholder is entitled to appraisal rights, and payment of the fair value of his shares in the event of any of the following:⁷²

1. Consummation of a merger which requires shareholder approval, and in respect of which the said shareholder is entitled to vote (except with respect to any class or series of shares which remain outstanding after conclusion of the merger), or where the corporation is a subsidiary and the parent company is involved in a merger;⁷³
2. Conclusion of a share exchange in which the company is the party whose shares will be acquired, if the dissenting shareholder is entitled to vote on the exchange (except with respect to any class or series of the company's shares which are not part of the exchange);⁷⁴
3. A disposition of the company's assets, if the dissenter is entitled to vote on disposition;⁷⁵
4. Amendment of the company's articles of incorporation with respect to a class of shares which reduces the number of shares of a class owned by the dissenter to a fraction of a share if the corporation has the obligation or right to purchase the fractional share created;⁷⁶ or,
5. Any other amendment to the articles of incorporation, merger, share exchange or disposition of assets to the extent allowed by the articles, bylaws, or a resolution of the company's board of directors.⁷⁷

The various states in the US have adapted their statutes from the above section of the MBCA.

It is interesting to note that with the exception of section 13.02(a)(2) above which provides for share exchanges, events which could trigger appraisal under the MBCA are

⁷² See section 13.02(a) of the MBCA.

⁷³ See section 13.02(a)(1).

⁷⁴ See section 13.02(a)(2).

⁷⁵ See section 13.02(a)(3).

⁷⁶ See section 13.02(a)(4).

⁷⁷ See section 13.02(a)(5).

very similar to those that could trigger appraisal under the Companies Bill. The triggering acts under the section include mergers, disposal of assets and amendments of the company's articles of Incorporation. Similarly, clause 164 also provides for the same acts, with the exception of share exchange. In its place, clause 164 recognizes schemes of arrangement.

7. APPRAISAL RIGHTS IN NEW ZEALAND.

The Companies Act of New Zealand⁷⁸ provides for appraisal as a remedy for minority shareholders. Appraisal rights are incorporated into New Zealand company statute by sections 110 to 115 of the Act.

A shareholder who is entitled to vote on a particular resolution but who did not exercise that right may opt to have his shares purchased by the company where other shareholders have exercised their voting rights and passed the said resolution.⁷⁹ The shareholder must give a written notice of his request to the company within ten working days of the passing of the resolution,⁸⁰ and the board of the company must within twenty working days of receipt of such notice agree that the company purchase the shares or arrange for the purchase⁸¹ The purchase price is required to be "fair and reasonable".⁸² The Act recognizes the accrual of interest on the agreed price.⁸³

A company could apply to the court for an order exempting it from the obligation to purchase the shares on the grounds that the purchase could be fatal for the company, it could not reasonably be expected to finance the purchase or that requiring it to purchase the shares would be unjust and inequitable⁸⁴ and the court could make an appropriate order under the circumstance.⁸⁵

There were arguments that these provisions do not provide sufficient guidance or certainty to companies about how the share price is to be determined, neither do they

⁷⁸ Act 105 of 1993, hereafter referred to as "the Act".

⁷⁹ Section 110.

⁸⁰ Section 111(1).

⁸¹ Section 111(2).

⁸² Section 112(2).

⁸³ Section 112(B)(1).

⁸⁴ See section 114(1).

⁸⁵ See section 114(2) & (3).

indicate the date on which the price is to be determined.⁸⁶ The Act only requires that the company offer a “fair and reasonable price” to the member concerned. In *Natural Gas Corporation Holdings Ltd v Infratil*,⁸⁷ the court criticized the lack of detail in the minority buy-out provisions and expressed the view that appraisal provisions needed urgent review to make them more beneficial and workable.

It was for this purpose, among others, that the Companies (Minority Buy-out Rights) Amendment Act⁸⁸ came into being. A new section 112 was formulated which requires the board to give notice to the shareholder within 5 working days, of its intention to purchase his shares.⁸⁹ The Amendment Act provides that the method of valuation must be fair and reasonable and retained the default position of the law that valuation should be determined as a pro-rata share of the total value of the relevant class of shares, excluding minority discount except if the affected class is a minority class.⁹⁰ It however allows resort to a different method of valuation where the default valuation method would be clearly unfair to either party.⁹¹

Legal title to the shares passes to the company on the day the board gives notice of its offer to buy the shares.⁹² It has been argued that this would seem to give the company impetus to unduly prolong the offer process⁹³ The Amendment Act however provides for recourse to arbitration should the parties fail to agree on share value.⁹⁴ It provides for payment of interest on any amount which remains outstanding after the date on which it falls due and the rate of calculation of such interest is at the discretion of the tribunal.⁹⁵

It is submitted that the Amendment Act still retained many of the buy-out provision under the Companies Act but made certain remarkable changes like allowing resort to another method of valuation where the accepted method would be clearly unfair to one party and

⁸⁶ See the Explanatory note to the Companies (Minority Buy-out Rights) Amendment Bill.

⁸⁷ (2001) 3 NZLR 727.

⁸⁸ Act 65 of 2008, hereafter referred to as “the Amendment Act”.

⁸⁹ See section 112(1) of the Amendment Act.

⁹⁰ See section 112(2).

⁹¹ See section 112(3).

⁹² See section 112(C).

⁹³ See Holborow D. & Anderson S. “New Minority Buy-out Rules Pass into Law” Simpson Grierson Corporate Advisory October 2008 at 3

⁹⁴ See section 112(A).

⁹⁵ See section 112(B).

remarkably reducing the time-frame within which a company must give notice of its intention to purchase the shares, thereby reducing the time-frame of the whole process. It would appear that except for these changes, appraisal provisions under the Amendment Act are similar to that under Act 105 of 1993.

8. VALUATION OF SHARES - ARRIVING AT A FAIR VALUE.

Valuation of the dissenter's shares in the company is of paramount importance in appraisal. Once a member and the company have agreed on appraisal, the next pressing issue is how to arrive at the true value of such a member's shareholding in order to pay him off adequately without shortchanging either party to the transaction. A demand for appraisal by a member, or an offer of appraisal on the part of the company in itself should not, and does not usually resort to a deadlock or litigation.⁹⁶ Rather, arriving at the true value of the shares at that period does.⁹⁷ The underlying factor is that the value of shares is never static. From the time of purchase, to the time of appraisal, it keeps changing, depending on the company's performance per time.

On the issue of arriving at a fair value, the Companies Bill provides for the company to send a written offer of an amount which the directors consider to be fair value to the dissenter.⁹⁸ However, the Bill later stipulates that fair value should be determined as at the date on which, and time immediately before the company adopted the resolution which gave rise to appraisal.⁹⁹ It is submitted that this is not adequate guidance on how to determine fair value. The Bill is silent on the exact method of valuation to be applied.

There was a lack of uniformity in appraisal statutes of the different states in the US under the old code.¹⁰⁰ The stated value ranged from "actual value" to "full market value" and the nature of most cases precluded proof of value with mathematical precision.¹⁰¹

Some appraisal statutes e.g. section 262 of the Delaware Code require that the dissenting shareholder be paid a fair value for his shares. The question then arises, what is fair

⁹⁶ See Hagan *supra* at 84.

⁹⁷ See *First Western Bank Wall v Olsen* 2001 S. D. 16, 621 N.W. 2d 611, *Weinberger v UOP Inc* 457 A. 2d 701 (Del 1983); *Cavalier Oil Corporation v Harnett* 564 A. 2d 1137 (Del. 1989).

⁹⁸ Clause 164(11)(c).

⁹⁹ Clause 164(16).

¹⁰⁰ See Latin *supra* at 243.

¹⁰¹ See Lattin *supra* at 262.

value? It has been submitted that “fair value” is not the “market value” and its determination does not include any value created from the transaction giving rise to appraisal e.g. new management plans.¹⁰² Rather, appraisal should be of the company exactly the way it was being run as at the time of the said transaction. The member then receives interest based on his percentage shareholding.

In arriving at a fair value for the shares, the relevant facts and circumstances must be taken into consideration. In *Allied Chemical & Dye Corporation v Steel & Tube Co*,¹⁰³ the dissenting shareholders were contesting the selling price of the corporate asset. They alleged it was not a fair price. The appraisal had been based on replacement values. The court held that “sound value” was not a fair indication of the market or commercial value and further, the fact that they are usually quoted to potential investors did not detract from this conclusion. It then deducted fifty percent from the given valuation. The difficulty in determining the fair market value can further be seen from *Jones v Missouri-Edison Elec. Co*,¹⁰⁴ in which it took eleven years to determine the fair value of the dissenters’ shares. Generally however, the typical duration of appraisal cases has been estimated to be within twelve to twenty-four months after filing the petition.¹⁰⁵

There are different methods of valuation. Courts in Delaware use the discounted cash flow (DCF) method.¹⁰⁶ This is based on an assumption that the value of a company’s assets is equal to the current value of the expected cash flow from those assets into the future. The cash which a company can generate in future is determined and then, the current value of that future cash is determined using a discount rate.

Another method is the comparable companies method. This involves comparing the company with its publicly traded competitors in the same industry i.e. looking at particular indicators of economic performance e.g. profits, determining similar indicators for public companies and if the company’s value is known, determining how

¹⁰² See Jarvis GC “State appraisal statutes: an underutilized shareholder remedy” (May/June 2005) vol. 13, no.3 *The Corporate Governance Advisor* 16.

¹⁰³ 14 Del. Ch. 64 (1923).

¹⁰⁴ 135 Fed. 153 (E. D. Mo 1905, 144 Fed 765 (C. C. A. 8th, 1906), 199 Fed. 64 (C. C. A. 8th, 1912), 203 Fed. 945 (C. C. A. 8th, 1913), 233 Fed. 49 (C. C. A. 8th, 1916).

¹⁰⁵ Jarvis *supra* at 16. It must be noted that this is still considerably shorter than the duration of other types of complex litigation, which has been put at between three and five years

¹⁰⁶ *Ibid* at 16.

performance indicators compare to the company's share price (e.g. ratio of its share price to revenue) and applying the ratio to the company in question to arrive at a value.¹⁰⁷

A third method is a comparable transactions approach which uses multiples of valuation metrics (e.g. earnings and revenue), calculating them as the ratio of the transaction price to the metrics.¹⁰⁸

South Carolina has three common valuation methods which are net asset value, market value and discounted earnings or investment value.¹⁰⁹

- i. The net asset value method uses the company's balance sheet to obtain the book value of assets; it subtracts the book value of liabilities and arrives at the net asset (or equity) value of the company.
- ii. The market value method is in two forms. The first is the Guideline Company Method (GCM), which is used to compare similar corporations while the second involves the courts relying on previous sales of the shares of the closely held corporation. It has been submitted that this method is unreliable because shares of a loosely held corporation are rarely traded and the sale is usually between related parties.¹¹⁰
- iii. The third method is the earnings (or investment method) which is the same thing as the DCF method used in Delaware. It is premised on the idea that the value of a share is the equivalent of the current value of expected future cash flows.

A leading case on the determination of fair value is *First Western Bank Wall v Olsen*¹¹¹, which reached the Supreme Court of South Dakota. The issue for determination was what would amount to "fair value". The board of directors passed a resolution to convert the corporation from a C corporation to a Sub-Chapter corporation, in order to allow it market competitiveness, flexibility and opportunity for significant taxation and other financial advantages. It became necessary to amend its articles of Incorporation, which the majority did, forcing the minority shareholders to give up their shares for

¹⁰⁷ *Ibid* at 16 - 17.

¹⁰⁸ *Ibid* at 17.

¹⁰⁹ Hagan *supra* at 99.

¹¹⁰ *Ibid* at 99.

¹¹¹ 2001 S. D. 16, 621 N. W. 2d 611.

cancellation, in exchange for a fair value for them. The board unanimously decided that the book value should be taken to be the fair value of the shares. The minority received payment but later demanded payment of a deficiency. The petitioner applied to the court for judicial valuation of the dissenters' fractional shares.

The minority's expert witness submitted that the "fair value" as defined under the SDCL required the shares to be valued at a proportionate interest in the corporation as a going concern and the proposed value of the respondents' fractional share was higher than the amount paid by the Bank. The petitioner on the other hand insisted that "fair market value" was synonymous with "fair value" and relied on the definition given in the IRS Revenue Ruling 59-60,¹¹² (i.e. the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell, and both having reasonable knowledge of the relevant facts).

The court refused the petitioner's argument and accepted the appraisal methods given by the respondent, on the basis that the latter's shares were cancelled under a "squeeze-out". They could therefore not be regarded as willing sellers. It was further held that:

- i. had the legislature truly intended for the "fair value" to be the same as "fair market value", it would have expressly stated so;
- ii. fair market value was an incorrect method of valuation; and
- iii. the application of minority and non-marketability discounts were inequitable.

Judgment was entered in favour of the respondents and the petitioner was ordered to pay the difference between the previously-paid amount and the newly calculated fair value. On appeal, the Supreme Court unanimously affirmed the judgment of the circuit court.

In *Cavalier Oil Corporation v Harnett*¹¹³, the respondent, being dissatisfied with the offer made by the petitioner, instituted appraisal proceedings against the corporation. On appeal, the Supreme Court of Delaware held that application of a discount to a minority shareholder is contrary to the requirement that the company be viewed as a going concern and further, that refusing to give a minority shareholder the full proportionate value of his

¹¹² 1959 – 1 C. B. 237

¹¹³ 564 A. 2d 1137 (Del. 1989).

shares imposes a penalty for lack of control and unjustly enriches the majority who may freeze out the minority in order to reap a windfall after appraisal.

Another leading authority on valuation is *Weinberger v UOP Inc.*¹¹⁴ Prior to the case, the predominant theory on valuation was the Delaware block method, under which fair value is calculated by first assessing value to the company, based on its asset value, earnings value and market value and secondly, a percentage weight is given to each valuation. Then the weighted average of the three independent valuations is considered as the fair value of the company. After this case however, valuation methods were extended to include any techniques or methods generally considered to be acceptable to the financial community.

It has been submitted that there is no fixed approach for determining the value of minority shares, since each case has unique facts. Appraisal should strive to strike a balance between law and equity to ensure parties are treated fairly.¹¹⁵ It is submitted that the court's approach should be founded on fairness, after duly weighing the facts and circumstances of each case.

9. A COMPARISON OF SECTION 252 AND CLAUSE 164.

It is pertinent to note that there are similarities between section 252 and clause 164, notwithstanding that they serve different purposes. The primary similarity between section 252 and clause 164 is that they both provide for alteration of the company's memorandum of incorporation. Under the Act,¹¹⁶ an aggrieved member may make an application for an order in the event of any alteration of the company's memorandum under section 55 or 56. Similarly, an aggrieved shareholder may demand appraisal under the Bill¹¹⁷ if the company is considering adopting a resolution to amend its Memorandum of Incorporation in any manner materially adverse to the rights or interests of holders of any class of shares.

¹¹⁴ 457 A. 2d 701 (Del 1983).

¹¹⁵ Hagan *supra* at 103.

¹¹⁶ See section 252(2)(a).

¹¹⁷ See clause 164(2)(a).

Another similarity between the two is that a personal action is instituted on the basis of an act or omission being adverse to the aggrieved shareholder's rights while appraisal may also be demanded on this basis. For instance, under section 252, a member may make an application to the court for an appropriate order if he is of the opinion that any particular act or omission of the company is unfairly prejudicial, unjust or inequitable, or that its affairs are conducted in a manner which is unfairly prejudicial, unjust or inequitable to him or some other members. In the same vein, a shareholder may demand appraisal if the shareholder perceives that amendment to the company's Memorandum is materially adverse to the rights or interests of holders of any class of shares to which he belongs.¹¹⁸

There are also a number of differences between the transactions under section 252 and some of the transactions listed under clause 164. As will be recalled, clause 164(2)(b) provides for appraisal should the company propose to enter into one of the transactions contemplated in clauses 112, 113 and 114. Clause 112 deals with the disposition of the assets or undertaking of a company, clause 113 provides for proposals for merger or amalgamation while clause 114 deals with schemes of arrangements. However, section 252 does not expressly provide for all the transactions contemplated in clause 164(2)(b). Apart from section 252(2)(a) which recognizes alteration of the company's memorandum of incorporation as a basis for personal action, and is similar in form and content to clause 164(2)(a), which also recognizes amendment of a memorandum of incorporation in an adverse manner as to affect the rights or interest of shareholders of any class, all other transactions envisaged under section 252(2) namely alteration of the company's Memorandum; reduction of the company's capital; variation of share rights and conversion of a private company into a public company and *vice versa*, are completely different from those envisaged under clause 164(2)(b).

Secondly, the powers of the court are wider under section 252. The section accords the court an unfettered discretion such that it may even make orders for regulating the future conduct of the company's affairs.¹¹⁹ However, under clause 164, the court strictly has the power to determine the fair value of the shares in question and to order the company to

¹¹⁸ Clause 164(2)(a).

¹¹⁹ Section 252(3).

pay it,¹²⁰ or make an order deferring the company's obligation to pay, on the ground that it would not satisfy the solvency and liquidity test if the whole amount were to be paid.¹²¹ It may also determine that any other member of the company should be made a party to the suit as a dissenting shareholder, it may appoint appraisers to assist in determining the fair value, and it may allow a reasonable interest rate on the shares and make orders as to cost.¹²² These duties have been expressly listed in clause 164 and must be adhered to. Basically, clause 164 can work without court interference.

Another difference between an application under section 252 and that under clause 164 is that an application for personal action which falls into the category of acts listed under section 252(2) must be made to the court within six weeks after the date on which the special resolution is passed.¹²³ However, whatever be the act that triggers appraisal, the stipulated time limit is the same. The demand must be made by a dissenting shareholder to the company within twenty working days after receiving the company's notice that the resolution in question has been adopted. Under clause 164(14), the aggrieved shareholder may only apply to the court for determination of the fair value of the shares and an order directing the company to pay up, should the company fail to make an offer,¹²⁴ or he considers the company's offer to be inadequate.¹²⁵ It must be noted that apart from section 252(2), there is no time limit to applications made under section 252.

Further, an aggrieved member may resort to section 252 not only with regards to a particular act but also with regards to an omission.¹²⁶ However, under clause 164, specific acts of the company give rise to a demand for appraisal; there is no mention of omissions.

10. MERITS AND DEMERITS OF APPRAISAL.

The all important advantage of appraisal as a remedy for dissenting shareholders is that it affords a minority shareholder the opportunity to opt out of a corporation, instead of

¹²⁰ Clause 164(14).

¹²¹ Clause 164(13)(b)(ii).

¹²² Clause 164(15).

¹²³ Section 252(2).

¹²⁴ Clause 164(14)(a).

¹²⁵ Clause 164(14)(b).

¹²⁶ Section 252(1).

being coerced into going along with the decision of the majority to which he is opposed, thus fostering the notion that neither side loses.

Another advantage of appraisal is that the company is able to make major corporate decisions without being hindered by a small fraction of shareholders. A minority shareholder has a choice whether to ratify the decision of the majority or if not, to opt out of the corporation and receive the monetary value of his shares. This way, he is no longer solely at the mercy of the majority.

This remedy is however not without its shortcomings. The first major fallout of appraisal is the high likelihood of the majority resorting to freeze-outs. Freeze-out has been defined as any action by those in control which results in the termination of a stockholder's interest or a purpose to force liquidation or sale of a stockholder's shares.¹²⁷ In *Matteson v Ziebarth*¹²⁸, the plaintiff was the only person standing in the way of a sale of the entire stock of the corporation. He refused to let go of his stock unless certain conditions were met while the buyer refused to buy anything less than all of the corporation's stock. To eliminate the plaintiff, the defendant set up a new corporation whose stock was made available pro rata to all members of the old corporation except the plaintiff; merged the old into the new and agreed on the sale with all the other stockholders, having successfully eliminated the plaintiff. It would thus appear that it is possible for the majority to pass a resolution, with the aim of causing the minority to demand appraisal.

A leading authority on this issue is *Yuspeh v. Koch*.¹²⁹ The majority shareholders purchased thirty-four unissued shares, reorganized the corporation against the wishes of the minority shareholders, created a new corporation wholly owned by them and merged the former corporation into the new one. They used the leverage given them by the thirty four unissued shares to force the minority out in a freeze-out merger. They then required the minority shareholders to relinquish their shares for \$50 per share. The minority believed that the merger did not set their stock at fair market value and sued the majority for fraud and breach of fiduciary duty. The district court found in favour of the plaintiffs and the defendants filed an appeal at the Louisiana Fifth Circuit Court of Appeal. The

¹²⁷ Vorenberg *supra* at 1191.

¹²⁸ (1952) 40 Wash 2d 286, 242 P. 2d 1025

¹²⁹ 2002-698 (La. App.5th Cir. 2003) 840 So. 2d 41

defendants argued that the trial court erred by failing to treat the statutory dissenters' rights as the sole remedy available to the plaintiffs (which, according to them, the plaintiffs had lost by their failure to comply with the statutory procedures required by Louisiana Revised Statutes 12:131) and secondly, that the trial court had erred in recognizing causes of action for fraud and breach of fiduciary duty. The court held that as there was no provision in the Louisiana revised Statutes 12:131 nor in prior jurisprudence to suggest that the statute was the minority shareholder's sole remedy for attempting to receive a fair value for his shares and further that as the statute was completely silent on claims of fraud or breach of fiduciary duty, the minority shareholders were not exclusively limited to the dissenters' rights described in the statutes. The court concluded that the sole purpose of the issuance of the unissued shares was simply to obtain adequate voting percentage to enable the majority freeze-out the minority and held that the defendants committed fraud and breached their fiduciary duty to the corporation.

A further limitation on appraisal is the difficulty in arriving at an appropriate share value. As can be seen from the above cases, the usual practice is for companies to attempt to undervalue the dissenter's shares. On the other hand, the statutes and courts have also had the difficulty of determining the appropriate values of minority shares. It would appear that the courts are more inclined to rule in favour of the minority. Published decisions on appraisal from 1985-2000 show awards of well over 400 percent above the deal price have been given, median premiums of over 80 percent and average interest awards of over 9 percent.¹³⁰ It is submitted that a standard method of valuation should be formulated in South Africa so that both parties have a clear idea of the value of the said shares at about the time a demand for appraisal is tendered.

Further, appraisal is affected by complicated and demanding procedural rules. The procedures laid down by statutes are sometimes too complicated and demanding. This has in turn led several courts¹³¹ to conclude on the expediency of according minority shareholders the flexibility to pursue alternative causes of action. It is submitted for the purposes of the proposed appraisal rights in South Africa that one method of avoiding

¹³⁰ Jarvis *supra* at 17.

¹³¹ e.g. *Yuspeh v Koch* 2002-698 (La. App 5th Cir 2003) 840 So. 2d 41.

this problem is by simplifying as much as possible, some of the complicated procedures tied to the exercise of these rights.

11. MERITS AND DEMERITS OF PERSONAL ACTION.

Just like appraisal, there are advantages, as well as disadvantages to a personal action. The first advantage of a personal action is that it enables a minority shareholder to challenge the majority where their decision is deemed to be prejudicial, unjust or inequitable to his interests, or those of a class of members to which he belongs. The keyword here is unjust conduct. Thus, the remedy invariably curbs the excesses of the majority, who had previously been given a free hand in the decision-making process.

Secondly, under the Act,¹³² the personal action also extends to omissions, unlike appraisal which is limited specifically to actual conduct. Thus a personal action could avail a member who can assert that an omission of the company is unfairly prejudicial to him. The foresight in including the phrase “omission” in section 252(1) is laudable. This is because it is possible for the majority’s deliberate inactivity to be unjust to the minority, thereby giving rise to a personal action.

Thirdly, the primary focus of a personal action is not to afford the minority the chance to leave the company.¹³³ The emphasis is on righting the wrong committed against them. However, in an application for appraisal, a shareholder on commencing appraisal proceedings expects to leave the company and on submitting his demand has no further rights in respect of his shares.¹³⁴

Further, under section 252, the court has an unfettered discretion, to the extent that it can rule on future affairs of the company and also make alterations or additions to the company’s memorandum or articles.¹³⁵

The personal action is not without shortcomings. Firstly, it is only in the case of an unfairly prejudicial, unjust or inequitable conduct that the minority have respite from the

¹³² Section 252(1).

¹³³ Although the court may eventually order the company to purchase their shares.

¹³⁴ Clause 164(9).

¹³⁵ Section 252(4).

court. Otherwise they remain members and are stuck with the majority's decisions, however detrimental to their membership, in the absence of any fraud or illegality.

Another shortcoming of a personal action is that an application is completely at the cost of the aggrieved shareholder. It goes without saying that litigation is never cheap. Therefore, the respite sought may come at a huge cost to the dissenter. Worse still, in the event that the dissenter does not have the resources, mere availability of the remedy is of no use to him, and should the court rule against him, then all the time and money spent would have been in vain.

12. CONCLUSION AND RECOMMENDATION.

This study has examined and compared the personal action under section 252 and appraisal under clause 164. It considered the features of both remedies, their advantages and disadvantages. It is submitted that the personal action is a dependable remedy because the initial focus is not to allow the minority to leave the company, although it is not without its own problems as discussed above. In the same vein, any member resorting to appraisal should be aware of the problems involved in relying on this remedy. It is submitted that buy-out may not necessarily be the best remedy for an aggrieved shareholder. Rather, it should be seen as an option of last resort i.e. after duly weighing the situation and exploring all other options, since a shareholder who has sent in a demand has no further right in respect of his shares.¹³⁶

It is interesting to note the inclusion of clause 163 in the Companies Bill. This clause in effect retains the personal action as a remedy in South African company law. Therefore, under the new dispensation, a minority shareholder will have both options (i.e. both the personal action and appraisal) to choose from, as they will exist side by side. This implies that a dissenter can make an informed decision. He need only decide which remedy best suits his purposes, after duly considering issues such as: how the majority's conduct would affect his membership; whether he would still wish to remain a member under the circumstance; the cost of an application for personal action; the likelihood of success of

¹³⁶ Clause 164(9).

his application; the worth of his shareholding in the company and; the amount he is likely to receive for it, upon valuation. The answers to such questions would greatly assist a dissenting shareholder in deciding which remedy would work better for him.

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