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I hereby declare that I have read and understood the regulations governing the submission of LLM proposals as contained in the rules of the University of Western Cape, and that this proposal conforms to those regulations.

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## DECLARATION

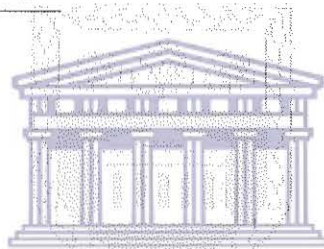
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## Abstract

Prior to 2010, as a result of a sluggish global economy, the amalgamation and merger procedure in South Africa was active although it was at an all-time low.<sup>1</sup> However, in 2010, there was an increase in amalgamation and merger activity in South Africa which was more pronounced in cross-border deals in South Africa and general corporate restructurings.<sup>2</sup> As a result of this, as well as the developed infrastructure that was placed in preparation for the FIFA 2010 World Cup, the country attracted more and more foreign markets to invest in South Africa which contributed to the increasing rate of amalgamations and mergers.<sup>3</sup>

Nevertheless, the global recession has also contributed to the increase in amalgamations and merger activity as many companies in South Africa have merged to buck the negative trend that most companies find themselves in, increase their revenue and work with each other to advance the position of the company on a par with those of its competitors. However, there are various other reasons as to why companies consolidate their assets and liabilities. Recently, Tiso Blackstar, a merged investment holding company, consolidated their assets, liabilities and skills between Blackstar Plc and Tiso Investment Holdings to expand its operations and to seek investment opportunities in Africa which is boasting with economic growth.<sup>4</sup> The company was of the opinion that the merger would not only enhance its scale and profitability, but it would also put the group on a new growth path.<sup>5</sup> There are many benefits in which companies may reap from amalgamations and mergers, but elucidating them is beyond the scope of this research.

As a result of the proliferation in the utilisation of amalgamations and mergers, as well as the increase in the complexity of the transactions between the companies, the 2008 Companies Act overhauled the existing company law regime and the amalgamation and merger legislative framework. However, the introduction of the new Companies Act had given rise to certain anomalies in relation to transactions between the

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<sup>1</sup> Davids E and Hale A 'The Mergers and Acquisitions Review' 4 ed (2010) 497.

<sup>2</sup> Davids and Hale (2010) 497.

<sup>3</sup> Davids and Hale (2010) 497.

<sup>4</sup> Mantshantsha S 'Tiso Blackstar will seek opportunities in Africa' (2015) *Business Day* 6.

<sup>5</sup> Staff Writer 'Blackstar confirms name change to Tiso Blackstar' (2015) *Business Day* available at <http://www.bdlive.co.za/business/media/2015/05/02/blackstar-confirms-name-change-to-tiso-blackstar> (accessed on 28 May 2015).

constituent companies. In addition, the Act provides a lack of guidance and uncertainties when implementing a proposed transaction.

The anomalies that are inherent in the 2008 Companies Act give rise to the present research. The literature considered in this research revealed and identified the discrepancies that exist in the new Companies Act 71 of 2008, more specifically, the inconsistencies that exist concerning the newly introduced amalgamation and merger provisions as set out in the 2008 Companies Act. This research was conducted to identify and address the implications of these inconsistencies on fundamental transactions, although much reference will be made to the amalgamation or merger. In this regard, the dissertation identified that although anomalies exist within the Act, the fundamental transactions work in practice and the amalgamation or merger concept is welcomed in South Africa's company law.

The findings from this research contribute valuable knowledge to both researchers and practitioners specialising in merger and acquisitions, while facilitating the achievement of the 2008 Companies Act in South African corporate law.

**Key words:** merger, amalgamations, appraisal rights, solvency and liquidity test, *pactum de non cedendo* and the business judgement rule.



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## **CHAPTER 1 – INTRODUCTION**

### **1.1. BACKGROUND**

The introduction of fundamental transactions contained in chapter 5 Part A of the Companies Act 71 of 2008 is increasingly seen as being beneficial to corporate efficiency, the economy and the creation of wealth.<sup>6</sup> According to Dr Robert Davis, the Minister of Trade and Industry, the new Companies Act is a major piece of legislation and reform which has a number of features to it that will improve the environment for business operation in South Africa.<sup>7</sup> The above appears to be delightful. Conversely, in the new Companies Act, a great number of inconsistencies and uncertainty emerges. Therefore, in implementing business transactions, businesses should not walk blindly to what appears too good to be true.

The new Companies Act 71 of 2008 ('2008 Companies Act') came into operation on 1 May 2011. It does not only rewrite the South African company law, but it also has other far-reaching effects.<sup>8</sup>

The Companies Act 61 of 1973 ('1973 Companies Act') governed South African company law for almost four decades and it was subjected to a plethora of amendments over the years. However, there was an exigency for company law to be meticulously modernised and consolidated to position it on a par with that of the developed world, as well as in line with global trends.<sup>9</sup> With the assistance of the United States ('US'), the United Kingdom ('UK'), Australian and Canadian academics, the new Companies Act was enacted. Through adopting elements from the laws of various jurisdictions, Boardman states that such absorption would improve efficiency

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<sup>6</sup> Cassim M 'The statutory merger in South African law' (2008) 16 *JBL* 40. Cassim also utters that by allowing flexibility for companies to restructure their businesses and adapt to ever changing business conditions, economic growth will be advanced.

<sup>7</sup> Department of Trade and Industry 'Minister Rob Davis launches new Companies Act Awareness Campaign' available at <http://www.gov.za/minister-rob-davis-launches-new-companies-act-awareness-campaign> (accessed on 12 March 2015).

<sup>8</sup> Driver G and Goolam H 'Fundamental transactions and their regulation by the Companies Act 71 of 2008' (2011) available at [http://us-cdn.creamermedia.co.za/assets/articles/attachments/32439\\_2011\\_03\\_cos\\_act\\_fundamental\\_transactions\\_gd\\_hg~1.pdf](http://us-cdn.creamermedia.co.za/assets/articles/attachments/32439_2011_03_cos_act_fundamental_transactions_gd_hg~1.pdf) (accessed on 12 March 2015).

<sup>9</sup> Davis *et al* 'Companies and other Business Structures' 3ed (2013) 219; see also Davids, Normitz and Yuill 'A microscopic analysis of the new merger and amalgamation provision in the Companies Act 71 of 2008' (2010) *Acta Juridica* 338.

and so encourage investment.<sup>10</sup> As a result, the 2008 Companies Act introduced a number of innovations although it retained much of the structure of the 1973 Companies Act.<sup>11</sup> Accordingly, it is interesting that the drafters of the 2008 Companies Act, with the assistance of foreign academics, adopted foreign concepts that were tailored to the unique South African context and policy goals. However, to put the improvements introduced by the 2008 Companies Act in motion, the legislators were also required to make them more protective than their American equivalents.<sup>12</sup>

In this dissertation, a close analysis will be made surrounding the newly introduced amalgamation or merger provisions documented in the 2008 Companies Act, which permits two or more companies to merge or combine their respective assets and liabilities into one or more surviving, or newly formed companies.<sup>13</sup> This was confirmed by the UK courts in the case of *Stanward Corporation v Denison Mines Ltd*<sup>14</sup> where Kelly JA held that by virtue of its statutory implementation, an amalgamated company is a fusion of two amalgamating companies, along with their assets and liabilities.<sup>15</sup> Cassim *et al* refer to the above process as a 'statutory merger'.<sup>16</sup>

Initially, the 1973 Companies Act did not expressly make available a mechanism for an amalgamation or merger. Therefore, only three traditional methods of acquiring control of a company were made available, namely:

- proposals to dispose of all or a greater part of the company's assets or undertaking;<sup>17</sup>
- proposals for a schemes of arrangement;<sup>18</sup> and
- proposals for a takeover offer.<sup>19</sup>

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<sup>10</sup> Boardman N 'A critical analysis of the new South African takeover laws as proposed under the Companies Act 71 of 2008' 2010 *Acta Juridica* 306.

<sup>11</sup> Davids *et al* (2010) 338.

<sup>12</sup> Davids *et al* (2010) 339.

<sup>13</sup> Companies Act 71 of 2008, s 113; see also Nicol B 'The legal effect of amalgamations and mergers upon third-party contracts containing anti-transfer provisions' (2013) 25 *SA Merc LJ* 30.

<sup>14</sup> *Stanward Corporation v Denison Mines Ltd* [1966] 2 O.R. 585.

<sup>15</sup> *Stanward Corporation v Denison Mines Ltd* [1966] 2 O.R. 585 592.

<sup>16</sup> Cassim *et al Contemporary Company Law* 2ed (2012) 675; see also Cassim M (2008) 40.

<sup>17</sup> The Companies Act 61 of 1973, s 228.

<sup>18</sup> The Companies Act 61 of 1973, s 311.

<sup>19</sup> The Companies Act 61 of 1973, s 440K.



Although much of the basic structure of the 1973 Companies Act was retained, the adoption of the 2008 Companies Act initiated a new era for South African company law and thus marked a dramatic liberalisation in legislative policy.<sup>20</sup> One of the leading reforms that the 2008 Companies Act introduces into South Africa is the US-style amalgamation or merger mechanism that is aimed at facilitating the creation of business combinations, as well as promoting flexibility and enhancing efficiency in the South African economy.<sup>21</sup> This was confirmed in the case of *R v Black and Decker Manufacturing Co*<sup>22</sup> where the court described the purpose of a statutory merger as 'economic: to build, to consolidate, perhaps to diversify, existing businesses so that through union there will be enhanced strength.'<sup>23</sup> However, the new statutory merger is not a substitution, but an additional procedure to the three above-mentioned methods under the previous regime.<sup>24</sup> Therefore, the 2008 Companies Act offers significant alterations to, as well as subtler polishing of the three traditional mechanisms by effectively retaining them in sections 112, 114 and 124 of the 2008 Companies Act.<sup>25</sup>

One of the notable alterations that the 2008 Companies Act introduced is the migration from a capital maintenance regime to a solvency and liquidity environment.<sup>26</sup> This was confirmed in the case of *Capitex Bank Ltd v Qorus Ltd*<sup>27</sup> where the court remarked that the solvency and liquidity requirements dramatically changed the capital maintenance rule as well as the perceived protection it afforded to shareholders and creditors.<sup>28</sup> In the previous regime, a fundamental principle on which the 1973 Companies Act was based was that a company must continuously maintain its share capital at the level of funding contributed by its shareholders. However, this rule was

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<sup>20</sup> Cassim M (2008) 42; Davids *et al* (2010) 337.

<sup>21</sup> Cassim *et al* (2012) 675; see also *Memorandum on the objects of the Companies Bill, 2008* (n 1) at para 9.

<sup>22</sup> *R v Black and Decker Manufacturing Co* [1975] 1 SCR 411 (SCC).

<sup>23</sup> *R v Black and Decker Manufacturing Co* [1975] 1 SCR 411 (SCC) 420.

<sup>24</sup> Cassim *et al* (2012) 675.

<sup>25</sup> Boardman (2010) 306.

<sup>26</sup> Pretorius and De Wit 'The solvency and liquidity test: Where did we come from? Where do we go from here?' available at <http://www.ensafrica.com/news/the-solvency-and-liquidity-test-where-did-we-come-from-where-do-we-go-from-here?Id=300&STitle=corporate%20commercial%20ENsight> (accessed on 9 April 2015).

<sup>27</sup> *Capitex Bank Ltd v Qorus Ltd* 2003 3 SA 302 (W).

<sup>28</sup> *Capitex Bank Ltd v Qorus Ltd* 2003 3 SA 302 (W) 306.

abolished and replaced by the solvency and liquidity test.<sup>29</sup> As a result, for a company to utilise the mechanisms provided for in sections 112, 113 and 114 of the 2008 Companies Act, the board of directors of the constituent companies are required to satisfy the solvency and liquidity test provided for in section 4 of the Act. For this reason, the board of directors must consider all reasonable foreseeable financial circumstances based on a fair valuation of the company's assets and liabilities, including any reasonable foreseeable contingent<sup>30</sup> assets and liabilities, as well as any other valuation that is deemed reasonable in the circumstances.<sup>31</sup> Unlike the Delaware General Corporation Law,<sup>32</sup> which requires the board of directors of the constituent companies to formally adopt a resolution approving of the merger and declaring that it is in the best interests of the company, the 2008 Companies Act instead merely requires the board of directors to consider whether the merged company would satisfy the solvency and liquidity test upon the implementation of the merger agreement.<sup>33</sup>

It is noteworthy that neither King I nor King II recognised fundamental transactions. However, as a result of the impact of the 2008 Companies Act on the company law, as well as the changes it made to business transactions, King IV recognises fundamental transactions with the aim of ensuring that directors are aware of their responsibilities and duties when initiating an amalgamation or merger, a disposal of all or a greater part of the company's assets or undertaking and a scheme of arrangement.<sup>34</sup> Wachtell *et al* confirm this, saying that due to the evolving legal landscapes, not only in the USA but everywhere around the world, there is an exigency for a board of directors to be fully informed of its fiduciary obligations, as well as for a company to be proactive and prepared to capitalise on business-combination opportunities.<sup>35</sup>

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<sup>29</sup> Stein C 'The new Companies Act unlocked' (2011) 174.

<sup>30</sup> *Wiseman v Acetable (Pty) Ltd* 1991 (4) SA 171 (W) at 176. In the case, Claasen AJ held that the contingent liability is the happening upon some future foreseeable event which may become a liability against the company. Similarly, contingent assets are assets that the company may acquire in the future.

<sup>31</sup> Davis *et al* (2013) 168.

<sup>32</sup> Delaware General Corporation Law 2001, s 251(b).

<sup>33</sup> Van der Linde 'The solvency and liquidity approach in the Companies Act 2008' (2009) 2 *TSAR* 233.

<sup>34</sup> King IV Report on Corporate Governance for South Africa 2016.

<sup>35</sup> Wachtell, Lipton, Rosen and Katz 'Takeover Law and Practice' available at <http://www.wlrk.com/files/2014/TakeoverLawAndPractice.pdf> (accessed on 12 April 2015).

The introduction of the new regime in fundamental transactions was in essence aimed at providing South African company law with a simple, uncomplicated and effective framework by which two or more companies may merge by agreement, with the approval of the prescribed majority of their shareholders without the general need for a court to approve the transaction.<sup>36</sup>

In the previous regime, court approval was required to initiate a business transaction. However, unlike the 1973 Companies Act, court involvement is now restricted to certain specified circumstances.<sup>37</sup> For this reason, court approval is only required where there is a significant minority, at least 15 per cent of the exercised voting rights, that are opposing the transaction and any of those shareholders demands that the company seeks court approval, or alternatively, where the court grants leave to a single shareholder to apply for a review of the transaction.<sup>38</sup> Accordingly, Cassim *et al* aver that the protective role and the involvement of the court in fundamental transactions have been considerably reduced under the 2008 Companies Act.<sup>39</sup>

As a result of the diminution in court involvement in the new company law regime, it seems that the 2008 Companies Act leaves the dissenting shareholders who disapprove of the transaction to fend for themselves. But, instead of recourse to court, dissenting shareholders are given the right to exercise their appraisal rights in terms of section 164 of the 2008 Companies Act and opt out by withdrawing the fair value of their shares in cash.<sup>40</sup> In the UK case of *Hogg v Cramphorn Ltd*, the court held that this right is designed to prevent dilution of the majority shareholder's interest and strength by the directors exercising their power of issuance in some improper way, whether to benefit themselves personally or to prevent some occurrence from happening.<sup>41</sup> Consequently, the appraisal right now functions as the prime protective measure for shareholders, thereby bypassing the necessity for general court approval

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<sup>36</sup> Cassim (2008) 40; Cassim M 'The introduction of the Statutory merger in South African Corporate Law: Majority Rule Offset by the Appraisal Right (Part 1)' (2008) 20 SA *Merc LJ* 1 (hereafter 'The introduction of the Statutory merger in South African Corporate Law'); Nicol B (2013) 30.

<sup>37</sup> Cassim *et al* (2012) 675.

<sup>38</sup> Companies Act 71 of 2008, s 115(3); see also s 115(3) to (6) as it provides for the circumstances which a company must seek court approval.

<sup>39</sup> Cassim *et al* (2012) 675.

<sup>40</sup> Companies Act 71 of 2008, s 164.

<sup>41</sup> *Hogg v Cramphorn Ltd* [1967] 1 Ch 254.

of such transactions.<sup>42</sup> Although this right is completely new to South African law, it has been a feature of American law for over a century and it has also been adopted in Canada<sup>43</sup> and New Zealand.<sup>44</sup>

Over and above the introduction of appraisal rights into the new company law regime, the 2008 Companies Act has also introduced a new business rescue procedure that is a key change to the amalgamation and merger sphere.<sup>45</sup> Akin to an amalgamation and merger, the business rescue procedure also affects the restructuring of the company by attempting to ensure that the company continues to trade on a solvent basis.<sup>46</sup> Therefore, the 2008 Companies Act provides for a procedure that simply reorganises a company that is in financial distress to restore it to a profitable entity and to avoid liquidation.<sup>47</sup> As a result, companies who are subject to financial difficulties are provided with a choice of either merging with another company to avoid the negative position they find themselves in and to increase its revenue by consolidating both their assets and liabilities, or alternatively, by initiating the business rescue procedure with the aim of resuscitating the company from liquidation.<sup>48</sup> Cassim *et al* hold that occasionally, the result of a business rescue procedure may be a takeover of the company suffering from financial distress by means of an amalgamation or merger.<sup>49</sup> Although mention is made to the business rescue proceedings provided for under chapter 6 of the 2008 Companies Act, a comprehensive discussion will not be made surrounding this area of company law for the purpose of this dissertation.

In addition to the afore-mentioned, the 2008 Companies Act also made an impact upon the Takeover Regulations that regulate the implementation of the fundamental transactions listed in sections 112, 113 and 114 of the 2008 Companies Act. The introduction of the Takeover Regulations has largely been influenced by the United Kingdom's City Code that was designed as a supervisory authority to regulate

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<sup>42</sup> Cassim *et al* (2012) 675.

<sup>43</sup> Canada Business Corporations Act 1985, s 184.

<sup>44</sup> New Zealand Companies Act 1993, s 4.

<sup>45</sup> Davids and Hale (2010) 498.

<sup>46</sup> Cassim *et al* (2012) 861.

<sup>47</sup> Cassim *et al* (2012) 861.

<sup>48</sup> Cassim *et al* (2012) 866 and 872; Cassim holds that there are two ways in which a company may be placed under business rescue proceedings, namely: voluntarily, by the passing of a resolution by the board of directors of the company, or compulsory, with an application to court by an affected person.

<sup>49</sup> Cassim *et al* (2012) 863.

takeover and merger transactions between constituent companies.<sup>50</sup> Under the old regime, only private companies with a share capital of over R5 million and with more than ten beneficial shareholders were subject to regulation by the Securities Regulation Panel (SRP). However, the new regime expanded the application of the Takeover Regulations by making the size and the number of shareholders in a private company irrelevant.<sup>51</sup>

It is clear that South Africa needed to revamp its company law; however, it is also evident that the introduction of the new regime has come at a price. There are a number of discrepancies that exist in the 2008 Companies Act that this dissertation will address.

## **1.2. PROBLEM STATEMENT**

The 2008 Companies Act has introduced a number of innovations into the South African company law on 1 May 2011. Not only has company law been reformed to facilitate business combinations, but also to promote efficiency in the economy. Unfortunately, the new Act has brought many inconsistencies, loopholes and uncertainty when implementing an amalgamation or merger. In this regard, it is apparent that the legislature has neither drafted the 2008 Companies Act in clear and unambiguous language, nor followed the user-friendly approach when drafting the Act. Furthermore, the legislature has placed much focus on putting the South African company law on par with international trends instead of avoiding all conflicts and discrepancies as much as possible. As a result, this may have a devastating effect on the boards of directors who are required to meticulously comply with the Companies Act when implementing a transaction, especially since the Act provides little or no guidance to directors. It is well documented that a poorly drafted statute will create confusion and conflict in practice and may eventually lead to fruitless grounds for litigation.

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<sup>50</sup> Slaughter and May 'A Guide to Takeovers in the United Kingdom' available at <https://www.slaughterandmay.com/media/39320/a-guide-to-takeovers-in-the-united-kingdom.pdf> (accessed on 16 April 2015) 3; Davids and Hale (2010) 497, Davids and Hale provides that unlike the UK City Code, the South African Takeover regulations are statutory and is enforced by the courts rather than through self-regulation.

<sup>51</sup> DLA Cliffe Dekker Hofmeyr 'Key aspects of the New Companies Act' (2012) *Everything matters* available at <http://www.cliffedekkerhofmeyr.com/export/sites/cdh/en/legal/sectors/downloads/Cliffe-Dekker-Hofmeyr-Key-Aspects-of-the-New-Companies-Act.pdf> (accessed on 20 February 2015) 4.

### **1.3. THE AIM OF THE RESEARCH AND RESEARCH QUESTION**

This dissertation will initially present a detailed textual analysis of the newly introduced amalgamation and merger provisions in the 2008 Companies Act. Furthermore, this dissertation will identify a number of anomalies that exist in the 2008 Companies Act, several of which are problematic areas. The analysis that this dissertation will present is focused on whether the amalgamation and merger procedure is fit for use.

The main research question is whether the amalgamation and merger, as a fundamental transaction, is competent of being utilised in the South African context in order to achieve the stated purpose of providing for equitable and efficient mergers, amalgamations and takeovers of companies.<sup>52</sup>

In answering the main question, the following sub-questions are to be answered to shed more light:

- Whether the inconsistencies and uncertainty in the 2008 Companies Act prevail over the innovations and benefits that the new Act has brought into the South African company law?
- Whether the takeover mechanisms in the 2008 Companies Act are better than that of the 1973 Companies Act?
- Whether the newly introduced amalgamation or merger procedure is prejudicial to dissenting shareholders, creditors and directors?

### **1.4. ISSUES THAT ARE EXAMINED**

This research dissertation seeks to analyse the 'amalgamation and merger' provisions in the 2008 Companies Act. The following issues will be addressed:

- the issues surrounding the interpretation of 'creditors' in an 'amalgamation and mergers' agreement,
- the solvency and liquidity test which the board of directors has to take into consideration when implementing an 'amalgamation and merger',

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<sup>52</sup> Davids *et al* (2010) 338, Davids *et al* aver that this was the drafter's intention in enacting the 2008 Companies Act 71 of 2008.

- the uncertainty attached to approvals of 'amalgamations or mergers' with reference to section 65 of the 2008 Companies Act,
- the possibility of terminating a merger agreement after it has been approved by the shareholders,
- the issues relating to cession when a merger or acquisition is being implemented; more particularly, the consequences of a contractual obligation which has a *pactum de non cedendo* or a non-assignment clause attached to it,
- the difficulties surrounding the implementation of statutory mergers in wholly-owned group companies,
- the uncertainty of determining the fair value of the shareholder shares when exercising their appraisal rights,
- whether the 2008 Companies Act introduces any protection mechanisms for directors failing to exercise their duties with the necessary care and skill when executing a merger.

## **1.5. LITERATURE REVIEW**

Writers have pointed out that the 2008 Companies Act contains many idiosyncrasies and ambiguities. At the same time, others have praised the 2008 Companies Act for introducing several innovations that are beneficial to the South African company law. As this paper seeks to identify all the anomalies within the 2008 Companies Act, provide recommendations to avoid such peculiarities, and determine whether the new concept of amalgamation and mergers will work despite the inconsistencies which exists within the Act, this dissertation will address the particular issue which not many scholars have done and thus provide a unique contribution to corporate law, as well as a proper guide to readers.

## **1.6. OUTLINE OF THE CHAPTERS**

This dissertation will consist of 4 chapters.

### **1.6.1. Chapter 1: Preliminary statements**

Chapter 1 briefly portrays the context and the background of this dissertation by describing the shift from the 1973 Companies Act to the new statutory regime, namely

the 2008 Companies Act. The chapter also sets out the objectives of the research and explains the method of research conducted, as well as the scope of this dissertation.

### **1.6.2. Chapter 2: The concept of amalgamation or merger**

Chapter 2 of this dissertation discusses the newly introduced concept of '*amalgamation or merger*' listed in chapter 5 Part A of the Companies Act. Furthermore, this chapter will address all the inconsistencies of the Companies Act when conducting an amalgamation or merger. Comparisons will also be made with the United States, the United Kingdom, as well as Australia where the particular issue arises.

### **1.6.3. Chapter 3: Protective measures for shareholders and directors**

Chapter 3 of this dissertation will briefly examine the protective measures that are inherent in the 2008 Companies Act. This chapter will initially present an analysis of the appraisal rights that the 2008 Companies Act makes available to dissenting shareholders. This chapter will also provide a brief discussion surrounding the newly introduced concept that was adopted into the new company law regime which protects directors in the case that they fail to make the appropriate business decision or fail to perform their duties with the necessary care and skill, namely the business judgement rule.

### **1.6.4. Chapter 4: Conclusion**

Chapter 4 encapsulates on the finding and aligns the conclusion found in this dissertation with the objectives of the research that was conducted for the purpose of this thesis. This chapter briefly encapsulates on the discussion surrounding the implications faced when entering into an amalgamation or merger as a result of the inconsistencies that are inherent in the 2008 Companies Act, and determines whether the new regime of entering into a transaction, especially the newly introduced concept of amalgamation or merger, is beneficial to company law despite the irregularity within the new Companies Act.



## 1.7. METHODOLOGY

For the purpose of this dissertation, the interpretative and comparative method of research was adopted with the aim of understanding and describing the provisions of the 2008 Companies Act.

The form of research that was employed in this study is an extended argument and it is supported by documentary evidences that will be used to focus on section 113 of the 2008 Companies Act and all the related provisions pertaining to the implementation of an amalgamation and merger. This part of the Act consists of various problematic areas that may give rise to much uncertainty. This research attempts to demonstrate that despite the inconsistencies and the uncertainty that emerge from the Act, as well as the effect it may have on the amalgamation and merger mechanism, the innovative concept is welcomed in South Africa's corporate law.

The research methodology consists of crucial analysis of the following documentary data in order to identify and address the irregularities that exist in the new Companies Act 71 of 2008:

- Primary source:
  - Relevant case law;
  - Applicable South African legislation such as the Companies Act 61 of 1973 and the Companies Act 71 of 2008; and
  - Relevant foreign legislation.
  
- Secondary source:
  - Commentaries and textbooks on the legislation by leading writers in the field.

In order to explore the new provisions, this thesis will consider the provisions of the 2008 Companies Act in the context of the existing South African takeover laws. In addition, this thesis will also analyse the provisions of the 2008 Companies Act against the comparable provisions in the United States of America, the United Kingdom, as well as Australia where points of particular interest arise.

To ensure that the reliability and the validity of the research will be upheld, the statutory rules for the interpretation of statutes will be observed. In addition, evidential weight

will be placed on the South African and foreign legislation, as well as on the relevant case law and commentaries by acknowledged specialists in the field. Furthermore, the research presents opposing viewpoints from various experts and the conclusion is grounded upon the preponderance of credible evidence.

Opinions submitted in numerous articles from various legal writers will be considered. Therefore, no interviews will be conducted. All the data collected for the purpose of this dissertation is in the public domain. For this reason, no ethical considerations will arise.

## **1.8. SCOPE OF DISSERTATION**

This dissertation will mainly focus on the provisions pertaining to the amalgamation or merger procedure, appraisal rights and the business judgement rule. The amalgamation or merger procedure is one of three fundamental transactions highlighted in the 2008 Companies Act. For the purpose of completeness, chapter 2 of this dissertation will briefly mention and discuss the remaining two fundamental transactions which companies may utilise to take over another company, namely a disposal of all or the greater part of the assets or the undertaking of a company and a scheme of arrangement.

## **1.9. DEFINING OF CONCEPTS**

'Appraisal remedy' - means the rights which may be exercised by a dissident as provided for in section 164 of the Companies Act,

'Constituent companies' – means two or more companies whom are parties to the fundamental transactions;

'Companies Act 61 of 1973' – the 1973 Companies Act which is considered to be the old Companies Act;

'Companies Act 71 of 2008' – the 2008 Companies Act which is considered to be the new Companies Act;

'Delaware Law' - means the Delaware Code under title 8, chapter 1. It is a legislation in terms of which corporations are incorporated and regulated in the State of Delaware;<sup>53</sup>

'Demand' - means the demand made by the dissident to the company for the payment of the fair value of the shares;<sup>54</sup>

'Directors' – means a member of the board of a company;

'Dissenting shareholders' – means shareholders who disapprove of the business transaction by which they avail themselves to the appraisal remedy;

'Meeting' - means a meeting of shareholders called for the purpose of considering and adopting a resolution;

'*Pactum de non cedendo*' – this is an agreement attached to a contract which seeks to prohibit a cession of a right.<sup>55</sup>

'Transfer by operation of law' – this is defined as the means by which a right or liability is transferred for a party, regardless of the latter's actual intention.<sup>56</sup>

'Voting rights' – with respect to any matter to be decided by a profits company, means the rights of any holder of the company's securities to vote in connection with that matter.<sup>57</sup>

## **1.10. STATEMENT OF ACKNOWLEDGEMENT**

I want to thank the Almighty Lord for giving me wisdom, strength and guidance to complete this research. I would also like to thank my wonderful parents; Regina and Robert Pessenbacher. None of this could have been possible without your unconditional support, encouragement and love.

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<sup>53</sup> Delaware Code, title 8.

<sup>54</sup> Companies Act 71 of 2008, s 164(5).

<sup>55</sup> Sunkel K 'A comprehensive suggestion to bring the pactum de non cedendo into the 21<sup>st</sup> Century' (2010) 3 *STELL LR* 463.

<sup>56</sup> Nicol B (2013) 35.

<sup>57</sup> Companies Act 71 of 2008, s 1.

I would also like to thank my supervisor, Advocate Fourie Kotze, for his support, guidance and constructive criticism in the completion of this dissertation.

To Professor Patricia Lenaghan, I would like to express my heartfelt appreciation for being a supportive lecturer and for giving me the opportunity to pursue my Masters of Law Degree in Corporate Law.

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## **CHAPTER 2 – FUNDAMENTAL TRANSACTIONS: MERGER OR AMALGAMATIONS**

### **2.1. INTRODUCTION**

In South African company law, there are a few basic ways to obtain control of a company, namely, by purchasing all the assets or properties of the business or by purchasing the shares of the company. Initially, all takeovers were governed by the 1973 Companies Act until it became obsolete and fell behind global trends. As a result, the 2008 Companies Act replaced the previous company law regime and restructured the South African company law by modernizing the framework. One of the results of this modernization is the introduction of the concept of 'fundamental transactions'.

Furthermore, the new Companies Act regulates corporate transactions more stringently than the 1973 Companies Act did.<sup>58</sup>

Although the new Companies Act does not contain a definition of the phrase fundamental transaction, it is acknowledged to be a generic term used to refer to the three types of corporate transactions falling within the ambit of chapter 5 Part A.<sup>59</sup> The transactions, which essentially alter a company, comprise of:

- an amalgamation or merger<sup>60</sup>,
- a disposal of all or the greater part of the assets or the undertaking of a company;<sup>61</sup> and finally,
- a scheme of arrangement.<sup>62</sup>

Broadly speaking, fundamental transactions encompass the manner and methodologies by which transactions are to be effected and regulated between the constituent companies.<sup>63</sup> Consequently, it is clear from the above that there are three forms of fundamental transactions, each with its own particular nuances, protections, advantages and disadvantages.<sup>64</sup>

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<sup>58</sup> Driver G and Goolam H 'Stringent regulation: company law' (2011) 11 *Without Prejudice* at 6.

<sup>59</sup> Cassim *et al* (2012) 674; Companies Act 71 of 2008, Chapter 5 Part A; Davis *et al* (2013) 203.

<sup>60</sup> Companies Act 71 of 2008, s 113.

<sup>61</sup> Companies Act 71 of 2008, s 112.

<sup>62</sup> Companies Act 71 of 2008, s 114.

<sup>63</sup> PWC 'Understanding the New Companies Act' available at <http://www.pwc.co.za/en/assets/pdf/companies-act.pdf> (accessed on 5 May 2015) 8.

<sup>64</sup> Cassim *et al* (2012) 675.

As mentioned in chapter 1, this dissertation will primarily focus on amalgamation and merger as a fundamental transaction. However, it is imperative that a clear and concise reference is made on the two remaining transactions which companies utilise to obtain control of another company. These are, firstly, the sale by a company of all or the greater part of the assets or undertaking. Section 112 of the Act will apply to an agreement where a company disposes or sells off more than 50 per cent of its gross assets to another company at fair market value.<sup>65</sup> The second fundamental transaction highlighted in section 114 of the Act is the scheme of arrangement.<sup>66</sup> This transaction refers to any agreement entered into between the company and holders of any class of its securities, including a reorganisation of the share capital of the company by way of:

- a consolidation of securities of different classes;
- a division of securities into different classes;
- an expropriation of securities from the holders;
- exchanging any of its securities for other securities;
- a re-acquisition by the company of its securities; or
- a combination of the above methods.<sup>67</sup>

Prior to the implementation of the 2008 Companies Act, the 2008 Companies Bill, insofar as the fundamental transactions are concerned, aimed to “*provide for equitable and efficient amalgamations, mergers and takeovers of companies.*”<sup>68</sup> The regulatory regime for fundamental transactions has thus been meticulously reformed under the new Companies Act to facilitate the formation of business combinations. For this reason, the Act introduced a fundamental and radically new concept of ‘*amalgamation or merger*’ into South African company law, which plays a very important role in the efficient allocation of resources belonging to the constituent companies.<sup>69</sup> It is peculiar that the objective of the 2008 Companies Bill did not make it into the ‘*purposes*’

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<sup>65</sup> Davis *et al* (2013) 203.

<sup>66</sup> Companies Act of 2008, s 114.

<sup>67</sup> Davis *et al* (2013) 206.

<sup>68</sup> Companies Act 71 of 2008.

<sup>69</sup> Cassim *et al* (2012) 675; Davids *et al* (2010) 337; see also Latsky J ‘The fundamental transactions under the Companies Act: A report back from practice after the first few years’ (2014) *Stell LR* 372, in which Johan Latsky provides that the merger or amalgamation concept was primarily adopted from the United States and Canadian law.

specified in section 7 of the 2008 Companies Act. For this reason, it is considered to be a regrettable oversight.<sup>70</sup>

Prior to the enactment of the 2008 Companies Act, there were no rules that regulated the combining of the constituent companies into one. The 1973 Companies Act provided a transaction akin to a merger which was limited to an approval from the court and the acquisition of shares by way of schemes of arrangement or through the sale of business as a going concern.<sup>71</sup> The merger transaction under the 1973 Companies Act however lacked simplicity and efficiency.

The Act fundamentally reformed company law by introducing gargantuan changes to the way fundamental transactions are regulated in South Africa. Nevertheless, besides the impact it has made on South African company law, there is no denying that there exist a number of qualms on a few issues pertaining to the new Act and its application to statutory mergers.<sup>72</sup>

In this dissertation, chapter 2 contains an analysis that will be based on the newly introduced concept of '*amalgamation or merger*', which is listed in chapter 5 part A of the 2008 Companies Act. In addition to the discussion of '*amalgamation or merger*', this chapter will also critically analyse the definition of '*amalgamation or merger*', the judicial nature, as well as the effect of the '*amalgamation or merger*' procedure. For the purpose of supporting the research of this dissertation, chapter 3 will provide a brief consideration of the protection mechanisms that the 2008 Companies Act has introduced in South African company law for the benefit of dissenting shareholders and directors.

## **2.2. AMALGAMATION OR MERGER**

### **2.2.1) Introduction**

In 1986, Ronald J Gilson once said that:

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<sup>70</sup> Davids *et al* (2010) (338).

<sup>71</sup> Boardman (2010) 306 and 307.

<sup>72</sup> Mashabane B 'Merger and takeover law: Impact on private companies' (2014) *De Rebus* 31.

*“at one moment two corporations exists; at the next, the acquiring corporation has enveloped the target, like an amoeba engulfing its prey, and has succeeded to all of its properties, rights and other attributes.”*<sup>73</sup>

Although similar to the present merger procedure, it is clear from Gilson’s statement that South Africa has traditionally never provided for a statutory merger procedure in its true sense, whereby two or more corporate entities amalgamate or merge into a single entity.<sup>74</sup> As a substitute, business combinations have generally been effected through the acquisition by one company of the shares or assets of another, using one of the traditional methods provided for in the 1973 Companies Act.<sup>75</sup>

Under the previous company law regime, transactions which fundamentally changed the nature of a company had their own unique procedures and requirements.<sup>76</sup> As a result, where two or more of these transactions were inter-conditional, the procedures provided for under the 1973 Companies Act often resulted in inefficiencies, including duplication of costs and unnecessary delays.<sup>77</sup> However, the 2008 Companies Act contains a new procedure that is flexible enough to enable most forms of business combinations. Although complex, the procedure may be implemented by way of a single, relatively simple and cheap procedure.<sup>78</sup>

In broad terms, the concept of amalgamation or merger or the so-called ‘statutory merger’ represents the pooling of assets and liabilities of two or more companies into a single company, which may be achieved either by combining companies or through a newly formed company.<sup>79</sup> The statutory merger under the new Act is not limited to the traditional concept of the pooling of two companies into one, but is wide enough to permit an assortment of merger structures, including triangular mergers, reverse triangle mergers, cash mergers and freeze-out mergers.<sup>80</sup> The adoption of a statutory merger not only represents a significant departure from the old regime but also aligns

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<sup>73</sup> Ronald J Gilson ‘*The Law and Finance of Corporate Acquisitions*’ (1986) Foundation Press: USA 505.

<sup>74</sup> Cassim *et al* (2012) 676; Davids *et al* (2010) 340.

<sup>75</sup> Cassim *et al* (2012) 676.

<sup>76</sup> Stein (2011) 284.

<sup>77</sup> Stein (2011) 284.

<sup>78</sup> Stein (2011) 284.

<sup>79</sup> Cassim *et al* (2012) 676.

<sup>80</sup> Cassim *et al* (2012) 702.



South African company law with a number of major jurisdictions worldwide, including the US, Canada, France and Germany, all of whom have some form of 'court-free' statutory merger procedure.<sup>81</sup>

In the current economic climate, there are various motives why mergers take place. Some of the common ones include:

- synergy (operational and financial);
- diversification;
- strategic re-alignment;
- market power;
- buying undervalued assets;
- tax considerations;
- legal and regulatory framework; and
- stakeholder expropriation.<sup>82</sup>

Conceptually, the statutory amalgamation or merger procedure seems to be a simple, uncomplicated and effective framework by which two or more companies may merge by agreement, with the approval of the prescribed majority of their shareholders, and without the general need for a court to approve the merger.<sup>83</sup> This is particularly interesting as the court is considered to be a main forum for approving important transactions to avoid disputes between parties. However, it is noteworthy that although judges have a wealth of experience in the field of legal practice, they are generally not experts in the commercial sphere.<sup>84</sup> Fortunately, the merger procedure provided for in the 2008 Companies Act is straightforward and flexible, which is upholding the new Companies Act's intention of facilitating business combinations. Davids *et al* concur that this procedure is significantly quicker and possibly less expensive than would ordinarily be in a court-driven procedure. Conversely, the scheme of arrangement procedure requires a judicial sanction, and this is deemed to be both a costly and lengthy procedure.<sup>85</sup>

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<sup>81</sup> Davids *et al* (2010) 341; Cassim *et al* (2012) 677.

<sup>82</sup> Osae WK, Fauconnier C.J and Webber Youngman R.C.W 'A value assessment of mergers and acquisitions in the South African mining industry – the Harmony ARMgold example' (2011) vol 111 *The Journal of the South African Institute of Mining and Metallurgy* 858.

<sup>83</sup> Cassim M (2008) 40.

<sup>84</sup> Schoeman N 'How the Companies Act impacts on directors' (2013) *Without Prejudice* 13.

<sup>85</sup> Davids *et al* (2010) 343.

It is clear from the above that the role of the court is restricted to certain specified circumstances.<sup>86</sup> Instead of recourse to a court, the liberalisation of the merger procedure under the 2008 Companies Act is counterbalanced by a provision that provides dissenting shareholders with the right to opt out by withdrawing the fair value of their shares in cash.<sup>87</sup> Although the court's limited involvement in corporate transactions may present increased prejudice for shareholders, this is remedied by the introduction of the appraisal rights set out in section 164 of the 2008 Companies Act.<sup>88</sup>

The statutory amalgamation or merger is a progressive and modernised procedure adopted from America, which fundamentally changes the nature of the company and thus assists companies in adapting to the changing conditions in the modern business world, in the interests of economic growth and wealth creation.<sup>89</sup>

The statutory amalgamation or merger represents a substantial liberalisation of policy on the part of the legislature by addressing the conflicting values of facilitating the restructuring of businesses in the interests of economic growth, as well as the interests of shareholders in retaining their investments in companies, together with the protection of minority shareholders from discrimination at the hand of the majority.<sup>90</sup> In retrospect, the 1973 Companies Act placed considerable emphasis on the latter value, whereas the 2008 Companies Act marks a dramatic shift in policy towards the former.<sup>91</sup> This shift in policy follows a similar trend with other jurisdictions that have all modernised their corporate law systems, such as America, Canada and New Zealand.<sup>92</sup>

The approach of the 2008 Companies Act falls in line with foreign trends and the underpinning policy of harmonization of South African company law with other leading jurisdictions. This shift in policy embodies a fundamental departure from our traditional

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<sup>86</sup> Cassim *et al* (2012) at 677.

<sup>87</sup> Cassim *et al* (2012) 677; see also Cassim 'The Introduction of the Statutory Merger in South African Corporate Law' (2008) 1.

<sup>88</sup> Davids *et al* (2010) 343.

<sup>89</sup> Cassim *et al* (2012) 677.

<sup>90</sup> Cassim *et al* (2012) 677; see also Cassim 'The Introduction of the Statutory Merger in South African Corporate Law' (2008) 1.

<sup>91</sup> Cassim *et al* (2012) 677.

<sup>92</sup> Cassim *et al* (2012); Cassim 'The Introduction of the Statutory Merger in South African Corporate Law' (2008) 1.

and historic adherence to English company law.<sup>93</sup> To this extent, neither English nor Australian law has adopted a court-free statutory merger procedure which, as a general principle, dispenses with the requirement of a court approval.<sup>94</sup> Instead, the English and the Australian law retained the traditional conservative approach contained in the 1973 Companies Act.<sup>95</sup>

In addition to the fact that the South African company law adopted a court-free procedure, it is apparent that in an amalgamation or merger transaction, the vesting of the properties and obligations in the surviving or new company occurs automatically, simply by operation of the law.<sup>96</sup> As a result, there is no need for compliance with any of the legal formalities associated with the transfer, save in terms of section 116(8) of the 2008 Companies Act. This is deemed to be one of the major advantages of this procedure, providing for simplicity and efficiency.<sup>97</sup> The obvious drawback to this procedure would be the automatic liability as all existing liabilities and claims will be transferred to the newly merged company or the company that survives the amalgamation or merger transaction.<sup>98</sup> This alone may pose a significant deterrent to mergers in practice, yet at the same time, the procedure is undeniably attractive due to its ease and effectiveness in concluding a transaction between the constituent companies.

### **2.2.2) The definition and concept of merger or amalgamation**

Section 1 of the 2008 Companies Act defines an amalgamation or merger as:

*“a transaction, or series of transactions, pursuant to an agreement between two or more companies, resulting in –*

*(a) the formation of one or more new companies, which together hold all of the assets and liabilities that were held by any of the amalgamating or merging companies immediately before*

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<sup>93</sup> Cassim *et al* (2012) 677.

<sup>94</sup> Cassim *et al* (2012) 677; Cassim *et al* notes that in English law, the court-free statutory merger procedure was in fact considered but was rejected as there appeared to be a lack of creditor protection and it could possibly infringe the rights of third parties to the respective merging agreements.

<sup>95</sup> Cassim 'The Introduction of the Statutory Merger in South African Corporate Law' (2008) 22.

<sup>96</sup> Cassim *et al* (2012) 681.

<sup>97</sup> Cassim *et al* (2012) 681.

<sup>98</sup> Cassim *et al* (2012) 681.

*the implementation of the agreements, and the dissolution of each of the amalgamating or merging companies; or*

*(b) the survival of at least one of the amalgamating or merging companies, with or without the formation of one or more new companies, and the vesting in the surviving company or companies, together with such new companies, of all of the assets and liabilities that were held by the amalgamating or merging companies immediately before the implementation of the agreement.*<sup>99</sup>

It is clear from section 1 of the Act that an amalgamating or merging company means a company that is a party to an amalgamation or merger agreement. Section 1 further elaborates on this by providing that an ‘amalgamated or merged company’ means:

*“a company that either –*

*(a) was incorporated pursuant to an amalgamation or merger agreement; or*

*(b) was an amalgamating or merging company and continued in existence after the implementation of the amalgamation or merger agreement, and holds any part of the assets and liabilities that were held by any of the amalgamating or merging companies immediately before the implementation of the agreement.*<sup>100</sup>

Cassim *et al* opine that although the terms ‘amalgamation’ and ‘merger’ appear to be synonymous or interlinked, no distinction is drawn between these concepts.<sup>101</sup> A fair amount of uncertainty thus exists as to how the definition of ‘amalgamation or merger’ should be approached.

Gad and Strauss aver that on the basis of the plain wording of the definition, a plausible interpretation would be that any transaction that results in the situations described in paragraph (a) or (b) of the definition, would be deemed to be an ‘amalgamation or merger’.<sup>102</sup> Therefore, transactions that differ from what would traditionally be

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<sup>99</sup> Companies Act 71 of 2008, s 1.

<sup>100</sup> Companies Act 71 of 2008, s 1; Cassim *et al* (2012) 678.

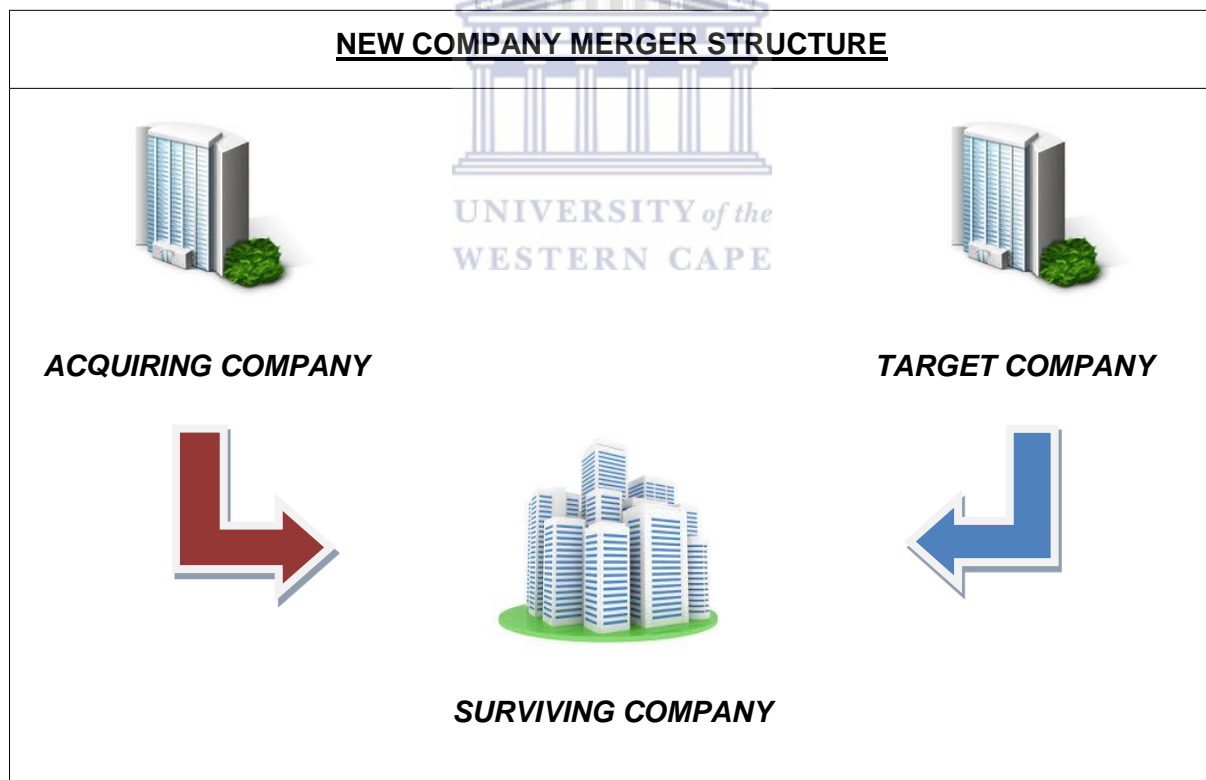
<sup>101</sup> Cassim *et al* (2012) 678.

<sup>102</sup> Gad R and Strauss J ‘The impact of statutory mergers on current tax Legislation: Part 1’ (2012) *ENSIGHT* [http://www.ens.co.za/news/news\\_article.aspx?iID=584&iType=4](http://www.ens.co.za/news/news_article.aspx?iID=584&iType=4) (accessed on 7 May 2015) 2.

regarded as an amalgamation or a merger may possibly be governed by the statutory merger provisions.<sup>103</sup>

Conversely, Davids *et al* submit that from the above definition of amalgamation or merger, there are two broad categories of transactions that qualify as an amalgamation or merger.<sup>104</sup> The first structure refers to two or more amalgamating or merging companies (the constituent companies) fusing into a new company, resulting in both the constituent companies being dissolved in the process. As a result, the new amalgamated or merged company is incorporated pursuant to the amalgamation or merger agreement itself and holds all the assets, as well as liabilities that were previously held by the two constituent companies.<sup>105</sup> Upon the effect of the merger, the vesting of such assets and liabilities in the merged company takes place automatically by the operation of law.<sup>106</sup> (refer to diagram 1 below)

**DIAGRAM 1**



<sup>103</sup> Gad R and Strauss J 'The impact of statutory mergers on current tax Legislation: Part 1' (2012) *ENSIGHT* [http://www.ens.co.za/news/news\\_article.aspx?iID=584&iType=4](http://www.ens.co.za/news/news_article.aspx?iID=584&iType=4) (accessed on 7 May 2015) 2.

<sup>104</sup> Davids *et al* (2010) 342; Cassim *et al* (2012) 678.

<sup>105</sup> Cassim *et al* (2012) 678.

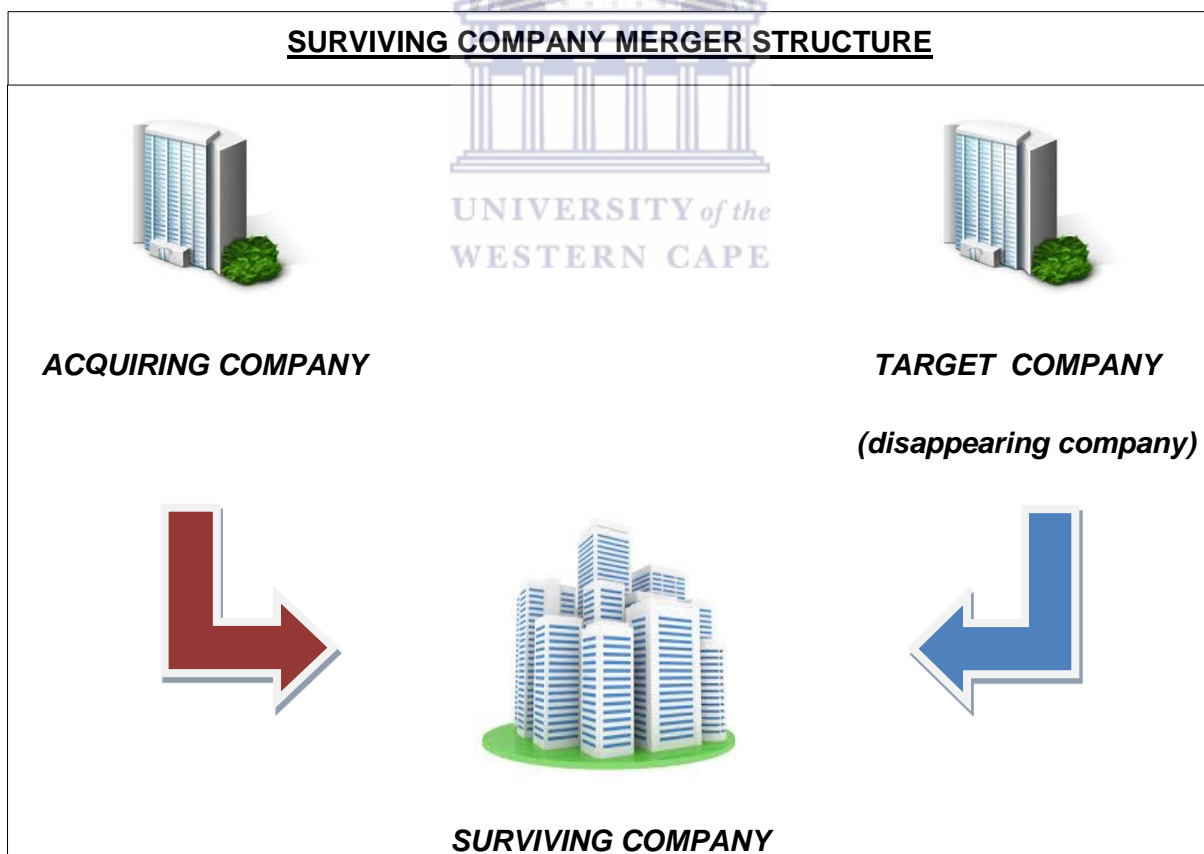
<sup>106</sup> Companies Act 71 of 2008, s 116(7); Cassim *et al* (2012) 678.

Transactions which satisfy the following requirement will be deemed to fall within paragraph (a) of the amalgamation or merger definition in section 1 of the Act':

- (i) at least one new acquiring company must be incorporated;
- (ii) every target company must be dissolved; and
- (iii) together all of the acquiring companies must hold all of the assets and liabilities that were previously held by the target companies.<sup>107</sup>

The second structure refers to one of the constituent companies fusing into the other constituent company, resulting in the survival or continuing existence of the latter company, in other words, the surviving company. As a result, all the assets and liabilities held by the constituent companies will vest, automatically by operation of the law, in the surviving company. The first constituent company, termed the disappearing company, disappears in the process.<sup>108</sup> (refer to diagram 2 below)

**DIAGRAM 2**



<sup>107</sup> Gad R and Strauss J 'The impact of statutory mergers on current tax Legislation: Part 1' (2012) *ENSIGHT* [http://www.ens.co.za/news/news\\_article.aspx?iID=584&iType=4](http://www.ens.co.za/news/news_article.aspx?iID=584&iType=4) (accessed on 7 May 2015) 3.

<sup>108</sup> Cassim *et al* (2012) 679; Davids *et al* (2010) 342.

As exemplified from the abovementioned merger structure, transactions that satisfy the following requirements will fall within paragraph (b) of the amalgamation or merger definition:

- (i) at least one of the target companies must survive; and
- (ii) together all of the assets and liabilities of the target companies must vest in all of the acquiring companies.<sup>109</sup>

Initially, in the 2007 Companies Bill,<sup>110</sup> a distinction was drawn between an 'amalgamation' whereby a company consolidates with another company and a new amalgamated company is formed, and a 'merger' whereby one company subsumes the other.<sup>111</sup> Therefore, a transaction described in paragraph (a) of the amalgamation or merger definition was defined as an 'amalgamation', and paragraph (b) as a 'merger'. This distinction was generally employed in American jurisdictions whereby the majority of the transactions were affected by mergers, as opposed to amalgamations, which were extremely rare.<sup>112</sup> Curiously, this distinction was not retained in the 2008 Companies Act as the Act defines an amalgamation or merger together and not separately. It is thus peculiar that in contrast to most jurisdictions, the 2008 Companies Act fails to treat the concept as one. Davids *et al* believe that the failure of the Companies Act to retain this distinction is a regrettable oversight, as it remains unclear whether these terms are simply interchangeable or reflect different transactions.<sup>113</sup>

Cassim *et al* aver that the concepts 'amalgamation' or 'merger' appear to be regarded as synonymous and interchangeable under the 2008 Companies Act.<sup>114</sup> Nevertheless, it is apparent from the 'amalgamation or merger' definition that there are technical differences between the two structures listed in paragraphs (a) and (b).<sup>115</sup> Consequently, in terms of paragraph (a), where an acquiring company and a target company wish to merge, both the constituent companies are dissolved and a new

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<sup>109</sup> Gad R and Strauss J 'The impact of statutory mergers on current tax Legislation: Part 1' (2012) *ENSIGHT* [http://www.ens.co.za/news/news\\_article.aspx?iID=584&iType=4](http://www.ens.co.za/news/news_article.aspx?iID=584&iType=4) (accessed on 7 May 2015) 3.

<sup>110</sup> GN 166 of 2007 in GG 29630 of 12 Feb 2007 (cl 1).

<sup>111</sup> Latsky J (2014) 372; Davids *et al* (2010) 342.

<sup>112</sup> Davids *et al* (2010) 342.

<sup>113</sup> Davids *et al* (2010) 342.

<sup>114</sup> Cassim *et al* (2012) 680.

<sup>115</sup> Cassim *et al* (2012) 680.

company is formed. On the other hand, in terms of paragraph (b), the acquiring company would survive and continue in existence, whereas the target company would be dissolved or deregistered.<sup>116</sup>

The abovementioned reveals how the 2008 Companies Act simplifies the possible transactions as it does not only make available transactions between two or more constituent companies, but it also creates scope for the survival of more than one company or the formation of more than one new company. The 2008 Companies Act also makes it possible for combinations of the two merger structures listed in paragraphs (a) and (b), whereby the merger results in at least one surviving company as well as the formation of one or more new companies.<sup>117</sup>

Although the 2008 Companies Act features technical differences between the two structures, the procedure for and the effect of the transaction are substantially similar, regardless of which of the two structures is used.<sup>118</sup>

In practice, there are a number of factors which reflect the choice between the two structures of an 'amalgamation' or 'merger', for instance:

- I. *the desire to portray the transaction as a true merger of equals. In this case the first structure, which results in the formation of a new company, may be preferred;*
- II. *the need to preserve the goodwill or identity of one of the constituent companies. This may necessitate the use of a merger into the relevant company, which would be the surviving company;*
- III. *the material provisions of the Memorandum of Incorporation of the constituent companies. This may determine whether the relevant company must survive or must disappear under the transaction; and finally,*
- IV. *the change of control provisions in material contracts between a constituent company and third parties.*<sup>119</sup>

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<sup>116</sup> Cassim *et al* (2012) 680.

<sup>117</sup> Cassim *et al* (2012) 680.

<sup>118</sup> Cassim *et al* (2012) 680; see also Cassim 'The Introduction of the Statutory Merger in South African Corporate Law' (2008) 3.

<sup>119</sup> Cassim *et al* (2012) 680 and 681.



It is clear that the 2008 Companies Act treats the concept of ‘*amalgamation or merger*’ as one procedure. For this reason and for the sake of convenience, in the rest of this dissertation the term ‘statutory merger’ will be used to refer to a merger or amalgamation.

### **2.2.3) The merger procedure**

The new statutory merger procedure applies to mergers between profit companies, including holding and subsidiary companies. However, it is noteworthy that the statutory merger provisions fail to extend to foreign or international companies that are engaged in statutory mergers with a South African company.<sup>120</sup> In this regard, not only is this overly restrictive in today’s global marketplace, it is also prejudicial to South African creditors who would have to claim against an offshore company where a South African corporate entity has merged with a foreign entity.<sup>121</sup> This approach thus needs to be reconsidered, as facilitating such mergers would be in interests of economic growth.<sup>122</sup> In contrast, the American Model Business Corporation Act 1984 permits mergers between domestic and foreign companies.<sup>123</sup> As a result, and as opposed to the 2008 Companies Act, the Model Business Corporation Act provides wider protection measures under its merger procedure that was designed to ensure fairness to shareholders and creditors of merging companies, regardless of its place of establishment. Therefore, the 2008 Companies Act should follow this approach as it would not only be beneficial to the economy, but it will also protect South African shareholders and creditors of domestic companies merging with foreign companies.

Many academics claim that there are three key stages of the statutory merger procedure. These are identified as:

- I. the merger agreement;
- II. the shareholder approval process; and
- III. the implementation of the merger.<sup>124</sup>

Cassim *et al* aver that the merger procedure is divided into five steps. The five key stages are as follows: (i) the merger agreement; (ii) the solvency and liquidity test; (iii)

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<sup>120</sup> Cassim *et al* (2012) 684.

<sup>121</sup> Davids *et al* (2010) 354.

<sup>122</sup> Cassim ‘The Introduction of the Statutory Merger in South African Corporate Law’ (2008) 8.

<sup>123</sup> Model Business Corporation Act 1984, s 11.02.

<sup>124</sup> Davis *et al* (2013) at 209; Davids *et al* (2010) 343.

the requisite approvals of the merger; (iv) notice to creditors; and, (v) the implementation of the merger.<sup>125</sup>

### **2.2.3.1) The merger agreement**

The primary step in the statutory merger procedure is that where the constituent companies are proposing to merge, they are required to enter into a written agreement that sets out the terms and manner of effecting the merger.<sup>126</sup> According to section 113(2) of the 2008 Companies Act, the merger agreement is required to deal with the following terms:

- (i) *the proposed Memorandum of Incorporation of any new company to be formed by the amalgamation or merger;*
- (ii) *the name and identity number of each proposed director of any proposed amalgamated or merged company;*
- (iii) *the manner in which the securities of each amalgamating or merging company are to be converted into securities of any proposed amalgamated or merged company, or exchanged for other property;*
- (iv) *if any securities of any of the amalgamating or merging companies are not to be converted into securities of any proposed amalgamated or merged company, the consideration that the holders of those securities are to receive in addition to or instead of securities of any proposed amalgamated or merged company;*
- (v) *the manner of payment of any consideration, where fractional securities are not being issued and where a juristic person is receiving payment, how the securities are to be paid or in what form they are to be received in the amalgamation or merger;*
- (vi) *details of the proposed allocation of the assets and liabilities of the amalgamating or merging companies, among the companies that will be formed or continue to exist when the amalgamation or merger agreement has been implemented;*
- (vii) *details of any arrangement or strategy necessary to complete the amalgamation or merger, and to provide for the subsequent management*

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<sup>125</sup> Cassim *et al* (2012) 684.

<sup>126</sup> Cassim *et al* (2012) 685.

*and operation of the proposed amalgamated or merged company or companies; and*

*(viii) the estimated cost of the proposed amalgamation or merger.*<sup>127</sup>

Although the terms that should be included in the merger agreement may be rigid in nature, the 2008 Companies Act places very little limitation on the substance of the agreement, and companies have considerable latitude to structure the merger transaction in a manner that best meets their needs or requirements. In short, the flexibility to accommodate the parties' desired commercial objectives is deemed to be one of the most significant advantages to the new 'amalgamation or merger' concept under the 2008 Companies Act.<sup>128</sup>

### **2.2.3.2) The solvency and liquidity test**

Upon the conclusion of the merger agreement, the boards of directors of each of the constituent merging companies are required to submit the transaction to their respective shareholders for approval.<sup>129</sup> However, the board of directors must determine whether each proposed merged entity would satisfy the solvency and liquidity test upon implementation of the merger agreement.<sup>130</sup> Section 113(1), (4) and (5) of the 2008 Companies Act provides that:

*(1) Two or more profit companies, including holding and subsidiary companies, may amalgamate or merge if, upon implementation of the amalgamation or merger, each amalgamated or merged company will satisfy the solvency and liquidity test.*

*(4) Subject to subsection (6), the board of each amalgamating or merging company-*

*(a) must consider whether, upon implementation, each proposed amalgamated or merged company must satisfy the solvency and liquidity test; and*

*(b) if the board reasonably believes that each proposed amalgamated or merged company will satisfy the solvency and liquidity test, it may submit the agreement for consideration at a shareholders meeting of that amalgamating or merging company, in accordance with section 115.*

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<sup>127</sup> Companies Act 71 of 2008, s 113(2); Cassim *et al* (2012) 685.

<sup>128</sup> Davids *et al* (2010) 344 and 345.

<sup>129</sup> Companies Act 71 of 2008, s 115.

<sup>130</sup> Companies Act 71 of 2008, s 113(1).

(5) Subject to subsection (6), a notice of a shareholders meeting contemplated in subsection (4)(b) must be delivered to each shareholder of each respective amalgamating or merging company, and must include or be accompanied by a copy or summary of –

(a) the amalgamation or merger agreement; and

(b) the provisions of section 115 and 164 in a manner that satisfies prescribed standards.

As seen from the above, section 113(1) of the Act provides a clear condition that companies may merge only if the merged company or companies satisfy the solvency and liquidity test.<sup>131</sup> This was confirmed in the case of *First Rand Bank Limited v Wayrail Investments (Pty) Ltd* where Vahed J held that the solvency and liquidity test is a tool for the purposes of implementing a merger or satisfying the restrictions imposed in or by the provisions of section 113 of the 2008 Companies Act.<sup>132</sup> The test is deemed to be a key safeguard for creditors of the merging companies as the companies would be prohibited from amalgamating or merging should either of the constituent companies fail to satisfy the solvency and liquidity test.<sup>133</sup>

The solvency and liquidity test is one of the underlying tenets of the new statutory regime moving away from the old capital maintenance regime.<sup>134</sup> Groves aver that although the test existed within the previous Act, the specific guidance provided within the 2008 Companies Act places a significant emphasis on the application and practical implications of this area of the Act.<sup>135</sup> However, the 2008 Companies Act extends the field of application of the solvency and liquidity requirements by regulating fundamental transactions and, as a consequence, operates as a protection measure in various transactions affecting the rights of creditors.<sup>136</sup>

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<sup>131</sup> Companies Act 71 of 2008, s 113(1); Davids *et al* (2010) 346.

<sup>132</sup> *First Rand Bank Limited v Wayrail Investments (Pty) Ltd* 2012 SA 684 ZAKZDHC at para 34

<sup>133</sup> Davids *et al* (2010) 346; Horwath 'The Solvency and Liquidity Test in terms of the Companies Act 2008' (2010) 27 available at

[https://www.crowehorwath.net/uploadedfiles/za/insights/talking\\_companies/talking%20companies%20-%20volume%2027%20-%20the%20solvency%20and%20liquidity%20test.pdf](https://www.crowehorwath.net/uploadedfiles/za/insights/talking_companies/talking%20companies%20-%20volume%2027%20-%20the%20solvency%20and%20liquidity%20test.pdf) (accessed on 8 May 2015) 1.

<sup>134</sup> Davids *et al* (2010) at 346.

<sup>135</sup> Grove C 'How will South Africa's new liquidity and insolvency test affect your company?' (2012) available at <http://www.gaaaccounting.com/how-will-south-africas-new-liquidity-and-solvency-test-affect-your-company/> (accessed at 30 March 2015).

<sup>136</sup> Van der Linde (2009) 225.

As mentioned in section 113(1) of the 2008 Companies Act, compliance with the solvency and liquidity test is an essential prerequisite for a merger.<sup>137</sup> Therefore, failure by a director to comply with section 4 of the 2008 Companies Act would render that director personally liable.<sup>138</sup> Section 4 of the 2008 Companies Act provides the following:

(1) *For any purpose of this Act, a company satisfies the solvency and liquidity test at a particular time if, considering all reasonably foreseeable financial circumstances of the company at that time -*

(a) *the assets of the company or, if the company is a member of a group of companies, the aggregate assets of the company, as fairly valued, equal or exceed the liabilities of the company or, if the company is a member of a group of companies, the aggregate liabilities of the company, as fairly valued; and*

(b) *it appears that the company will be able to pay its debts as they become due in the ordinary course of business for a period of –*

- (i) *12 months after the date on which the test is considered; or*
- (ii) *in the case of a distribution contemplated in paragraph (a) of the definition of distribution in section 1, 12 months following that distribution.*<sup>139</sup>

Section 4 of the Act evidently contains a dual test comprising of a solvency element and a liquidity element, both of which must be satisfied.<sup>140</sup> The solvency test requires that the assets of the company should exceed its liabilities after the transaction has taken place. The solvency test is often referred to as solvency in the bankruptcy sense and it is determined through the application of a balance sheet test.<sup>141</sup> This is distinguished from equity solvency or the ability to satisfy one's debts as they become due, which refers to the liquidity element described in paragraph (b) of section 4(1) of the 2008 Companies Act.<sup>142</sup> There are two main approaches to a liquidity test, the first entailing a balance sheet test based on current assets and liabilities, whilst the second involves a cash flow analysis which does not only take into account current assets and

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<sup>137</sup> Cassim *et al* (2012) 688; J Latsky (2014) 372.

<sup>138</sup> Companies Act 71 of 2008, s 77(2).

<sup>139</sup> Companies Act 71 of 2008, s 4.

<sup>140</sup> Van der Linde (2009) 225; Companies Act 71 of 2008, s 4(1)(a) and (b).

<sup>141</sup> Van der Linde (2009) 225.

<sup>142</sup> Van der Linde (2009) 225.

liabilities, but also takes into account future assets and income, as well as prospective liabilities.<sup>143</sup> As a result, for a merger to be successful, the test requires that the company not only be solvent, in other words, that its assets exceed its liabilities, but also that the company is liquid whereby it is able to pay its debts as they become due in the ordinary course of business.<sup>144</sup>

Van der Linde avers that the solvency element will be satisfied '*at a particular time*' if a consideration is made to all reasonably foreseeable financial circumstances of the company at the time the fair value of the company's assets equals or exceeds its fairly valued liabilities.<sup>145</sup> The solvency or balance sheet test determines the net assets or liabilities at a specific moment in time, while the requirement regarding the consideration of all reasonably foreseeable financial circumstances involves a measure of prediction. Therefore, the solvency element is clearly formulated objectively with reference to a particular point in time.<sup>146</sup>

It is noteworthy that a comparison of the solvency requirements with those of the requirements in the different jurisdictions illustrates that the current South African test is relatively lenient and out of step with international trends. The reason for this is that the South African test is satisfied whenever the assets equal the liabilities following a transaction.<sup>147</sup> However, unlike the South African test, which does not provide for a solvency margin, the California Corporations Code provides for two alternative balance-sheet restrictions, each of which requires a margin of assets over liabilities subsequent to a transaction.<sup>148</sup>

The liquidity element will be satisfied if, considering all reasonably foreseeable financial circumstances of the company at the time, it appears that the company will be able to pay its debts as they become due in the course of business for a period of twelve months.<sup>149</sup> The 2008 Companies Act introduced the liquidity element as a

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<sup>143</sup> Van der Linde (2009) 226.

<sup>144</sup> Companies Act 71 of 2008, s 4(1)(b).

<sup>145</sup> Van der Linde (2009) 227. If the company is a member of a group of companies, the aggregate assets of the company, as fairly valued, must equal or exceed the aggregate liabilities of the company, as fairly valued.

<sup>146</sup> Van der Linde (2009) 227.

<sup>147</sup> Van der Linde (2009) 228.

<sup>148</sup> California Corporations Code, s 500 – 509.

<sup>149</sup> Van der Linde (2009) 229.

prerequisite to ensure companies are financially healthy before and after merger transactions. In *Ex parte De Villiers NNO: In re Carbon Developments (Pty) Ltd*<sup>150</sup>, it was held that the liquidity element fits in well with the representation a company is said to make when it incurs debt, which is, that it reasonably expects to be able to pay as and when the debt becomes due.<sup>151</sup>

Initially, the 1973 Companies Act contained no specific time or period at which the solvency and liquidity test had to be met. As a result, there was considerable uncertainty in the application of the test.<sup>152</sup> However, the legislature adopted the time period from the 2006 UK Companies Act<sup>153</sup> and placed it in the 2008 Companies Act.<sup>154</sup> Therefore, the 2008 Companies Act introduced the 12-month requirement in section 4 (1)(b) to give directors more certainty when applying the test, thus protecting the creditors.<sup>155</sup> Conversely, Van der Linde contests that the 12-month time period may disadvantage the creditors that have clearly foreseeable longer-term commitments that are not payable within twelve months.<sup>156</sup> Furthermore, Van der Linde criticises the imposition of a time limit in the 2008 Companies Act as undesirable and argues that the ordinary course of business of each company should be the decisive factor in judging its liquidity.<sup>157</sup>

However, Van der Linde's criticisms do not validate why the 12-month period is detrimental to creditors. Firstly, the time frame is beneficial as it eradicates uncertainty when directors apply the solvency and liquidity test. It is difficult to comprehend on how liability can be imposed on directors if they fail to reach a reasonable conclusion if no guideline such as a time frame is given. Secondly, the board of directors of the constituent company will not be able to make a cash flow prediction without reference to a time frame. Without a time frame, it would require a great deal of money and time

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<sup>150</sup> *Ex parte De Villiers NNO: In re Carbon Developments (Pty) Ltd (in liquidation)* 1993 (1) SA 493 (A).

<sup>151</sup> *Ex parte De Villiers NNO: In re Carbon Developments (Pty) Ltd (in liquidation)* 1993 (1) SA 493 (A) 504.

<sup>152</sup> Stein (2011) at 176; Stein provides that the 1973 Companies Act used vague expressions in relation to the solvency and liquidity test, such as 'subsequent to providing the assistance and for the duration of the transaction'.

<sup>153</sup> UK Companies Act 2006, s 714 (3)(b).

<sup>154</sup> Van der Linde (2009) 229.

<sup>155</sup> Stein (2011) 176.

<sup>156</sup> Van der Linde (2009) 229.

<sup>157</sup> Van der Linde (2009) 229.

to verify what time frame would be appropriate for each company, thus contradicting the purpose of the 2008 Companies Act to provide for equitable, as well as efficient mergers and takeovers. As a result, it is clear that the time period is appropriate when applying the solvency and liquidity test.

In applying the test, the solvency element requires that the directors make a prediction of the position of the constituent companies immediately after the implementation of the transaction rather than on the actual financial position of the company. This equally applies to the liquidity element.

When applying the test, the directors of the constituent companies will be required to consider all reasonably foreseeable financial circumstances of the company at the time the test is applied. This implies a predictive element, requiring the directors to take into account matters which may not be reflected in the accounting records and financial statements of the company, but are rather based on elements such as how the economy or political circumstances may impact on the financial state of the company in the future.<sup>158</sup>

Any financial information concerning the relevant company and which is to be considered by the directors must be based on the accounting records and financial statements that satisfy the requirements of the 2008 Companies Act. Furthermore, the board or any other person applying the solvency and liquidity test '*must*' consider the fair values of the company's assets and liabilities, including any reasonably foreseeable contingent assets and liabilities; and '*may*' consider any other valuation of the company's assets and liabilities that is deemed reasonable in the circumstances.<sup>159</sup>

In contrast to the New Zealand corporate law,<sup>160</sup> the 2008 Companies Act does not require the board of directors of the constituent companies to formally adopt a

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<sup>158</sup> K Pretorius and T De Wit 'The solvency and liquidity test: Where did we come from? Where do we go from here?' (2010) *ENSight* <http://www.ensafrica.com/news/the-solvency-and-liquidity-test-where-did-we-come-from-where-do-we-go-from-here?Id=300&STitle=corporate%20commercial%20ENSight> (accessed 9 April 2015) at 2.

<sup>159</sup> K Pretorius and T De Wit 'The solvency and liquidity test: Where did we come from? Where do we go from here?' (2010) *ENSight* <<http://www.ensafrica.com/news/the-solvency-and-liquidity-test-where-did-we-come-from-where-do-we-go-from-here?Id=300&STitle=corporate%20commercial%20ENSight>> (accessed 9 April 2015) 2.

<sup>160</sup> New Zealand Companies Act 1993, s 221(1)(a).



resolution approving of the merger and declaring that it is in the best interests of the company. However, like the Canadian Law,<sup>161</sup> the 2008 Companies Act instead requires the board of each constituent company to consider whether the merged company would satisfy the solvency and liquidity test upon implementation of the merger agreement.<sup>162</sup>

Therefore, it is compulsory for the directors of the constituent companies to consider the fair values of the company's assets and liabilities. Furthermore, the boards of directors are subjected to a stringent obligation to consider the foreseeable contingent assets and liabilities of the constituent companies. This puts a lot of pressure on the directors, as they are required to make the right determination whereby if they fail to do so, they would be held personally liable for any mistakes made during this determination. However, to provide the directors with some guidance in this determination, the directors 'may' consider any other valuation of the company's assets and liabilities that is considered to be reasonable in determining the contingent assets the constituent companies could acquire, and liabilities that the companies could incur. Pretorius *et al* assert that despite the 2008 Companies Act's welcome extension of the solvency and liquidity regime, the Act fails to provide concrete principles to assist directors who are required to apply the test.<sup>163</sup>

In applying the solvency and liquidity test, the 2008 Companies Act does not require that the company be solvent and liquid. Instead, the directors must objectively be 'satisfied' that the company would satisfy the solvency and liquidity test.<sup>164</sup> Therefore, it must reasonably appear that the company will satisfy the solvency and liquidity test

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<sup>161</sup> Canada Business Corporations Act 1985, s 185(2).

<sup>162</sup> Cassim 'The Introduction of the Statutory Merger in South African Corporate Law' (2008) 15.

<sup>163</sup> K Pretorius and T De Wit 'The solvency and liquidity test: Where did we come from? Where do we go from here?' (2010) *ENSight* <<http://www.ensafrica.com/news/the-solvency-and-liquidity-test-where-did-we-come-from-where-do-we-go-from-here?Id=300&STitle=corporate%20commercial%20ENSight>> (accessed 9 April 2015) 2.

<sup>164</sup> K Pretorius and T De Wit 'The solvency and liquidity test: Where did we come from? Where do we go from here?' (2010) *ENSight* <<http://www.ensafrica.com/news/the-solvency-and-liquidity-test-where-did-we-come-from-where-do-we-go-from-here?Id=300&STitle=corporate%20commercial%20ENSight>> (accessed 9 April 2015) 2.

and the board must acknowledge, by resolution, that it has applied the solvency and liquidity test, as well as reasonably concluded that the company will satisfy the test.<sup>165</sup>

When the board of directors objectively consider whether the merger is in the best interests of the company, they are subjected to a fiduciary duty to act in good faith in the best interests of the company and the duty to exercise an unfettered discretion.<sup>166</sup> In the case of *Sealy Mattress Co of NJ Inc v Sealy*, the Delaware Court of Chancery held that in relation to the duty of care, a merger that has not been subjected to a properly informed director judgement will be barred from being submitted to the shareholders.<sup>167</sup> Therefore, it is absolutely imperative that when making a decision upon whether the merging companies satisfy the solvency and liquidity test, and even when negotiating a merger agreement, the board of directors is required to do so honestly and in the best interests of the company, whilst making a properly informed judgement on the merits and the advisability of the merger agreement, and the financial circumstances of the company.<sup>168</sup>

After considering whether each merged company will satisfy the solvency and liquidity test, if the board of directors of each constituent company reasonably believes that this will be the case, they are then required to call a shareholders' meeting to consider the transaction.<sup>169</sup> This is quite a daunting task for directors as they will be held personally accountable to the company falling insolvent within the 12-month period and it could reasonably be established that they could have foreseen this.<sup>170</sup> In addition, the inclusion of an objective 'reasonableness' standard for the board's determination as opposed to a subjective 'good faith' standard may increase the risk

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<sup>165</sup> K Pretorius and T De Wit 'The solvency and liquidity test: Where did we come from? Where do we go from here?' (2010) *ENSight* <<http://www.ensafrica.com/news/the-solvency-and-liquidity-test-where-did-we-come-from-where-do-we-go-from-here?Id=300&STitle=corporate%20commercial%20ENSight>> (accessed 9 April 2015) 2.

<sup>166</sup> Cassim 'The Introduction of the Statutory Merger in South African Corporate Law' (2008) 15.

<sup>167</sup> *Sealy Mattress Co of NJ Inc v Sealy* 532 A 2d 1324 (Del Ch, 1987).

<sup>168</sup> Cassim 'The Introduction of the Statutory Merger in South African Corporate Law' (2008) 16.

<sup>169</sup> Companies Act 71 of 2008, s 113(2) read with s 115.

<sup>170</sup> 'Directors: the new move to solvency and liquidity . . . control your risk' available at <http://bgrwellington.co.za/blog/directors-the-new-move-to-solvency-and-liquidity-control-your-risk/> (accessed on 12 May 2015).

of challenges by creditors. However, the 2008 Companies Act has taken sound steps to safeguard creditors.<sup>171</sup>

Once the boards of directors of the merging companies 'reasonably believe' that each proposed entity will satisfy the test, in similar fashion to the case with the other two fundamental transactions, a notice of a shareholders' meeting must be delivered to each shareholder of each respective merging company. The notice must be accompanied by a copy or summary of the merger agreement containing an explanation surrounding the required approvals for the transaction and the appraisal rights of dissenting shareholders.<sup>172</sup> This is imperative as shareholders may be unaware of their appraisal rights and the procedure for their exercise, or of the provisions regarding court approval.<sup>173</sup>

Although the solvency and liquidity test recognises the practicalities of modern business and protects creditors, it is clear that there exist a number of peculiarities and anomalies surrounding the test.<sup>174</sup>

According to section 4(1) of the 2008 Companies Act, a company satisfies the solvency and liquidity test if, considering all reasonably foreseeable financial circumstances of the company at the time -

*(a) the assets of the company or, if the company is a member of a group of companies, the aggregate assets of the company, as fairly valued, equal or exceed the liabilities of the company or, if the company is a member of a group of companies, the aggregate liabilities of the company, as fairly valued; and*

*(b) it appears that the company will be able to pay its debts as they become due in the ordinary course of business. . . . .<sup>175</sup>*

From the solvency element in section 4(1)(a) of the Act, the intention appears to have been that the solvency test must be considered at both the company and the group level. However, the wording corresponding to the group of companies appears to be anomalous and obscure, as the distinction makes no difference. For this reason,

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<sup>171</sup> Davids *et al* (2010) 346.

<sup>172</sup> Latsky J (2014) 372; Cassim *et al* (2012) 689.

<sup>173</sup> Cassim *et al* (2012) 689.

<sup>174</sup> Stein (2011) 174.

<sup>175</sup> Companies Act 71 of 2008, s 4(1).

where the company is a member of a group of companies, the references should have been to the aggregate assets and liabilities of the '*consolidated group*' and not of '*the company*'.<sup>176</sup>

Section 4(1)(a) of the Act also requires an assessment of the group position '*if the company is a member of a group of companies*'.<sup>177</sup> The wording in section 4(1)(a) however implies that simply because the relevant company happened to be a subsidiary, the entire group would have to be subject to the solvency and liquidity test. The wording in section 4(1)(a) also appears to indicate that the '*group*' also covers the relevant company's holding company and all that holding company's subsidiaries. This appears to be peculiar and impractical. For this reason, section 4 of the Act would more sensibly deal with a required assessment of a group situation if the wording were altered to '*if the company is a holding company*' instead of '*if the company is a member of a group*'.<sup>178</sup>

It is evident from section 4(1)(a) that the Act requires consideration of factual solvency from both the company and the group if the company is a member of a group of companies. However, section 4(1)(b), which provides for the liquidity element, oddly only makes reference to the company and not the group of companies. This appears to be a clear omission requiring amendment, as there would be no logical reason for the liquidity consideration to be limited to the company and not extended to the group of companies.<sup>179</sup>

Furthermore, as seen from the wording of section 4(1) of the Companies Act, the solvency and liquidity test will be satisfied if all the reasonable foreseeable financial circumstances of the company are considered. This clearly depicts a purely objective element as it requires the directors to '*reasonably*' take into account the solvency and liquidity element described in section 4(1)(a) and (b), thus involving a measure of prediction.<sup>180</sup> However, Van der Linde aver that this fits in well with the liquidity element which necessarily involves a forecast; whereas the solvency element rather involves a subjective element, requiring the directors to take into account the assets and

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<sup>176</sup> Wainer HE 'The New Companies Act: Peculiarities and Anomalies' (2009) SALJ 807.

<sup>177</sup> Wainer HE (2009) 807.

<sup>178</sup> Wainer HE (2009) 807.

<sup>179</sup> Wainer HE (2009) 807.

<sup>180</sup> Van der Linde (2009) 227.

liabilities at the time the test is considered.<sup>181</sup> To avoid confusion, it would have been preferable for the legislator to insert the reference to '*reasonably foreseeable circumstances*' in the liquidity test rather than in the solvency test.<sup>182</sup>

According to section 113(1) of the 2008 Companies Act, the constituent companies may merge if, upon implementation of the merger, each merged company will satisfy the solvency and liquidity test. Section 4(1)(b) of the Act provides that the liquidity element will be satisfied provided that it appears that the company will be able to pay its debts for a period of 12 months after the date on which the test is considered. The question therefore arises when the test is to be considered. The Companies Act explicitly provides that the test must be satisfied upon the implementation of the merger, but it fails to provide concrete guidance on when the test is considered. However, Davids *et al* assert that before the merger agreement is submitted to the respective shareholders, the board of directors is required to consider whether each merged entity will satisfy the solvency and liquidity test.<sup>183</sup> For this reason, it is clear that the test will be considered before it is submitted to the relevant shareholders for approval.

As mentioned above, should the board of directors fail to make the right determination when considering the solvency and liquidity test, and 12 months after the test is conducted the business falls insolvent, the directors will be held personally accountable for their conduct and for any loss sustained by the company in terms of section 77(2) of the Act if it could reasonably be established that the directors could have foreseen this.<sup>184</sup> Furthermore, the court may also place such director under probation in terms of section 162(7)(a)(i).<sup>185</sup> Although it is clear that the directors will suffer the consequences for not making a reasonable prediction, the 2008 Companies Act is silent on the position of the transaction thereafter. Van der Linde submits that the directors are only required to make a reasonable prediction. Therefore, the solvency and liquidity test is satisfied even if the prediction later appears to have been

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<sup>181</sup> Van der Linde (2009) 227.

<sup>182</sup> Van der Linde (2009) 227.

<sup>183</sup> Davids *et al* (2010) 346.

<sup>184</sup> "Directors: the new move to solvency and liquidity . . . control your risk" available at <http://bgrwellington.co.za/blog/directors-the-new-move-to-solvency-and-liquidity-control-your-risk/> (accessed on 12 May 2015).

<sup>185</sup> Roodt Inc 'The solvency and liquidity test – what it means and when it applies' available at <http://www.roodtinc.com/newsletter45.asp> (accessed at 5 May 2015).

wrong.<sup>186</sup> As a result, the transaction will persist despite the directors' failure to appropriately carry out the test. This is highly disadvantageous as it may have a detrimental effect on the company wishing to merge with another company.

To encapsulate, the solvency and liquidity test is an appropriate restriction and a suitable protection measure for creditors affected by the merger. However, it is clear that the test is exceptionally problematic; this can be rectified through better formulation and careful cross-referencing.<sup>187</sup> Despite the test being flawed by several problems and uncertainties, the test is welcomed in South Africa's company law.

### **2.2.3.3) The requisite approvals of the merger**

The third step in the merger procedure is that the merger must be approved in accordance with section 115 of the 2008 Companies Act, failing which it may not be implemented at all.<sup>188</sup> This step has been inserted to protect minority shareholders, as well as to strike a balance between this protection and the wishes of the overwhelming majority of shareholders.<sup>189</sup> Section 115(1) of the 2008 Companies Act provides that:

- (1) Despite section 65, any provision of a company's Memorandum of Incorporation, or any resolution adopted by its board or holders of securities, to the contrary, a company may not dispose of, or give effect to an agreement or series of arrangements to dispose of, all or the greater part of its assets or undertaking, implement an amalgamation or a merger, or implement a scheme of arrangement, unless –*
- (a) the disposal, amalgamation or merger, or scheme of arrangement*
    - (i) has been approved in terms of this section; or*
    - (ii) is pursuant to or contemplated in an approved business rescue plan for that company, in terms of Chapter 6 . . .<sup>190</sup>*

As depicted from the above, a merger is required to be approved by shareholders of each merging company by way of special resolution.<sup>191</sup> Cassim *et al* hold that the requirement of a meeting called for that purpose is an essential requirement because of the exclusion of section 65 and any contrary provision of the company's

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<sup>186</sup> Van der Linde (2009) 236.

<sup>187</sup> Van der Linde (2009) 240.

<sup>188</sup> Cassim *et al* (2012) 689.

<sup>189</sup> Stein (2011) 294.

<sup>190</sup> Companies Act 71 of 2008, s 115(1).

<sup>191</sup> Stein (2011) 287.

Memorandum of Incorporation.<sup>192</sup> In terms of section 115(2) of the 2008 Companies Act:

*(2) A proposed transaction contemplated in subsection (1) must be approved –*

*(a) by a special resolution adopted by persons entitled to exercise voting rights on such a matter, at a meeting called for that purpose and at which sufficient persons are present to exercise, in aggregate, at least 25 per cent of all of the voting rights that are entitled to be exercised on that matter, or any higher percentage as may be required by the company's Memorandum of Incorporation, as contemplated in section 64(2). . .<sup>193</sup>*

A quorum of shareholders entitled to exercise at least 25 per cent of the voting rights exercisable in respect of the relevant matter is required and a special resolution is necessary to approve the transaction.<sup>194</sup> The quorum for the meeting may be increased in a company's Memorandum of Incorporation, but it may not be decreased. However, shareholders who do not have voting rights in connection with the transaction are excluded from the quorum.<sup>195</sup> A special resolution, as mentioned above, is required to be adopted with the support of at least 75 per cent of the voting rights that are actually exercised on the resolution.<sup>196</sup> Both the quorum and the prescribed shareholder approval requirements relate to the percentage of voting rights, in other words, the rights of any holder of the company's securities to vote in connection with that matter, and not to the percentage of shareholders or shares.<sup>197</sup>

According to section 1 of the 2008 Companies Act, a special resolution is adopted with the support of at least 75 per cent of the voting rights exercised on the resolution or a different percentage as contemplated in section 65(10) of the Act.<sup>198</sup> Section 65(10) of the 2008 Companies Act provides that:

*(10) A company's Memorandum of Incorporation may permit –*

*(a) a different percentage of voting rights to approve a special resolution; or*

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<sup>192</sup> Cassim *et al* (2012) 690.

<sup>193</sup> Companies Act 71 of 2008, s 115(2)(a); Stein (2011) 294, Stein claims that section 115(2)(a) does not provide for separate voting by holders of different classes of shares, at separate class meetings.

<sup>194</sup> Davids *et al* (2010) 347.

<sup>195</sup> Cassim *et al* (2012) 690.

<sup>196</sup> Cassim *et al* (2012) 690; Bouwman N "Quorums and Resolutions" (2010) 10 *Without Prejudice* at 19.

<sup>197</sup> Cassim *et al* (2012) 690.

<sup>198</sup> Companies Act 71 of 2008, s 1.

(b) one or more different percentages of voting rights to approve special resolutions provided that there must at all times be a margin of at least ten percentage points between the highest established requirement for approval of an ordinary resolution on any matter, and the lowest established requirement for approval of a special resolution on any matter.<sup>199</sup>

There appears to be some uncertainty attached to the applicability of the abovementioned provision. A question arises as to whether a company's Memorandum of Incorporation may validly alter the necessary percentage of voting rights to approve a special resolution regarding a fundamental transaction. One of the notable changes the 2008 Companies Act presented to the current company law regime is that a company's Memorandum of Incorporation may stipulate that a higher percentage of voting rights will be required to approve an ordinary resolution.<sup>200</sup> At the same time, a company's Memorandum of Incorporation may also permit a lower percentage of voting rights to approve a special resolution.<sup>201</sup> However, the alterations to the Memorandum of Incorporations are subject to the requirement that a margin of at least 10 per cent always be maintained between the requirements for approval of ordinary and special resolutions on all matters.<sup>202</sup>

Although clause 119(1) of the Companies Bill 2007 explicitly precluded such alteration, the position under the 2008 Companies Act is less clear. Cassim *et al* assert that since section 115 of the 2008 Companies Act applies despite section 65 and any provision of a company's Memorandum of Incorporation; this would bar a company from relying on section 65(10) of the Act to alter the 75 per cent threshold for a fundamental transaction to be approved.<sup>203</sup> Consequently, on strict application, the 75 per cent threshold appears to be fixed and unalterable as section 115 explicitly excludes section 65 of the Companies Act.

Shareholders are however not left without respite. In spite of this fixed threshold, shareholders who desire greater protection in the event of a proposed merger may simply provide in the company's Memorandum of Incorporation for an increased

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<sup>199</sup> Companies Act 71 of 2008, s 65(10).

<sup>200</sup> Bouwman (2010) 19.

<sup>201</sup> Bouwman (2010) 19.

<sup>202</sup> Bouwman (2010) 19.

<sup>203</sup> Cassim *et al* (2012) 690.



quorum for the meeting.<sup>204</sup> Consequently, a merger can thus only proceed if the transaction has obtained the approval of a greater percentage of the total voting rights of the company.

The shareholder approval requirement ensures better protection for minority shareholders whilst preserving flexibility for companies to effect fundamental changes without allowing the dissenting shareholders to frustrate the merger.<sup>205</sup> However, it is notable that the approval requirements are fairly lenient and liberal in comparison with other jurisdictions. For example, under the American Model Business Corporation Act, the approval of a transaction is required to be supported by a minimum vote of over 25 per cent of the total votes of the company.<sup>206</sup> Under the Delaware law, usually 50 per cent of all the issued shares of a company is required for a transaction to be approved.<sup>207</sup>

In the event where shareholders holding 15 per cent or more of the voting rights vote against the proposed merger, any dissenting shareholders that voted against the resolution, may within five business days after the vote, require the company to seek court approval for the transaction.<sup>208</sup> Therefore, the resolution will not be implemented until such approval is obtained. For this reason, the company opting for the transaction is required to apply to the court for such approval and bear the costs of the application or treat the resolution as a nullity.<sup>209</sup>

Regardless of whether there is a 75 per cent majority vote in favour of the resolution, any shareholder who has voted against the resolution, also has the right to apply directly to the court within 10 business days after the vote for a review of the transaction.<sup>210</sup> In this case, the court may grant leave to apply for review if it is satisfied that the dissenting shareholders are acting in good faith, it appears that the applicants are prepared to sustain the proceedings and the alleged facts prove the findings

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<sup>204</sup> Cassim *et al* (2012) 691.

<sup>205</sup> Cassim *et al* (2012) 691.

<sup>206</sup> Revised American Model Business Corporation Act, s 11.04(e).

<sup>207</sup> Delaware General Corporation Law 2001, s 251(c); Cassim *et al* (2012) 691, Cassim *et al* aver that most states in the United States of America still implement an absolute majority voting requirement based on a percentage of all the issued shares of a company.

<sup>208</sup> Companies Act 71 of 2008, s 115(3)(a).

<sup>209</sup> Companies Act 71 of 2008, s 115(5).

<sup>210</sup> Companies Act 71 of 2008, s 115(3)(b).

reflected in section 115(7)(a) and (b) of the 2008 Companies Act. Section 115(7) of the Act provides that:

*(7) On reviewing a resolution that is subject of an application in terms of subsection (5)(a), or after granting leave in terms of subsection (6), the court may set aside the resolution only if –*

*(a) the resolution is manifestly unfair to any class of holders of the company's securities; or*

*(b) the vote was materially tainted by conflict of interest, inadequate disclosure, failure to comply with the Act, the Memorandum of Incorporation or any applicable rules of the company, or other significant and material procedural irregularity.<sup>211</sup>*

Therefore, where the majority is between 75 and 85 per cent, any dissenting shareholder may seek relief by requiring the company to seek court approval. Consequently, this emphasizes the increased minority shareholder protection afforded by the 2008 Companies Act.<sup>212</sup> Despite the reduction of court involvement and court approval in certain circumstances, the discretion of the court in these circumstances is very wide.<sup>213</sup>

This protection is deemed to be unique to South African company law as it generally does not exist in other jurisdictions that have legislation dealing with mergers.<sup>214</sup>

Although the 2008 Companies Act expressly provides for protection when implementing a merger agreement, it is not clear whether a merger agreement may be cancelled or terminated between the signing of the agreement and the closing of the transaction if adverse changes befall the target company. In America, both the Delaware<sup>215</sup> and Canadian<sup>216</sup> legislation explicitly allows for merger agreements to contain a Material Adverse Change ('MAC') clause that provides the board of directors the right to terminate the merger at any time before the implementation of the merger, and to do so despite the shareholder approval of the merger.<sup>217</sup> However, such

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<sup>211</sup> Companies Act 71 of 2008, s 115(7).

<sup>212</sup> Delport P 'The New Companies Act Manual' 2ed (2009) 89.

<sup>213</sup> Sloane J 'A discussion and comparison of company legislation and tax legislation in South Africa, in relation to amalgamations and mergers' (2014) *Rhodes University* 33; see also Companies Act 71 of 2008, s 115(3).

<sup>214</sup> Davids *et al* (2010) 347.

<sup>215</sup> Delaware General Corporation Law 2001, s 251(d).

<sup>216</sup> Canada Business Corporations Act 1985, s 183(6).

<sup>217</sup> Cassim (2008) 18. Cassim holds that such clauses may be useful where the merger loses appeal, which may occur where there is a significant number of dissenting shareholders who exercise their

clauses are subject to the requirement that the events leading to the termination must typically have an adverse effect on the business, its assets, liabilities or operations of the target company and its subsidiaries.<sup>218</sup>

Despite the fact that MAC clauses have become an important part of the machinery driving agreement in most public company deals in the USA, the 2008 Companies Act does not contain such a provision allowing for a MAC clause to be attached to merger agreements.<sup>219</sup> The legislature ought to remove any doubts relating to the termination of merger agreements by inserting a provision, similar to the statutory provisions in Delaware and Canada, which would empower the directors to abandon a merger at any time before it is filed for implementation, regardless of shareholder approval.<sup>220</sup> The introduction of such a provision may be useful as companies intending to merge will not only have the knowledge of attaching such a clause to a merger agreement, but they too may avoid shooting themselves in the foot where unforeseen circumstances may arise, thus protecting themselves from merging with a company that may have lost appeal or which may be detrimental to the company instituting the clause.

#### **2.2.3.4) Notice to creditors**

For the first time in South African corporate law, the 2008 Companies Act enables companies to effect a merger without the consent of its creditors, thus leaving creditors clueless as to their current transactions with the company involved.<sup>221</sup> For this reason, the Act establishes a procedure that the shareholders must comply with before implementing a merger. Once a special resolution has been adopted and the requisite shareholder approval has been obtained by each of the merging companies, the fourth step of the merger procedure is to notify all known creditors, in the prescribed manner

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appraisal rights so that the resultant demands on the cash resources of the company render the merger impracticable; or alternatively where a merging company occurs substantial losses as a result of some unforeseen disaster.

<sup>218</sup> Robert Driman 'MAC clauses revisited' (2012) available at <http://www.nortonrosefulbright.com/knowledge/publications/68710/mac-clauses-revisited> (accessed at 2 June 2015).

<sup>219</sup> Nickig J 'Triggers for withdrawing from M&A deals' (2010) 10 *Without Prejudice* 20.

<sup>220</sup> Cassim (2008) 18.

<sup>221</sup> Driver G and Goolam H 'Fundamental transactions and their regulation by the Companies Act No. 71 of 2008' (2011) available at [http://us-cdn.creamermedia.co.za/assets/articles/attachments/32439\\_2011\\_03\\_cos\\_act\\_fundamental\\_transactions\\_gd\\_hq~1.pdf](http://us-cdn.creamermedia.co.za/assets/articles/attachments/32439_2011_03_cos_act_fundamental_transactions_gd_hq~1.pdf) (accessed on 12 March 2015).

and form, of the merger.<sup>222</sup> Section 116(1)(a) of the 2008 Companies Act provides as follows:

(1) *Subject to subsection (2), after the resolution approving an amalgamation or merger has been adopted by each company that is party to the agreement –*

(a) *each of the amalgamating or merging companies must cause a notice of the amalgamation or merger to be given in the prescribed manner and form to every known creditor of that company;*<sup>223</sup>

Before the constituent companies may notify the creditors of the merger, it is imperative to establish which creditors are to receive the notice, and who can exercise the rights provided for in section 116(1) of the 2008 Companies Act. It is notable that there is no definition of 'creditor' in the Act.<sup>224</sup> In the Companies Amendment Bill, a 'creditor' was defined as a person to whom a company may be obligated in terms of any liability or other obligation that would be required to be considered by the company if it were applying the solvency and liquidity test.<sup>225</sup> Nevertheless, this definition was ultimately jettisoned.

The dictionaries provide the following definitions of a 'creditor'; "a person or company to whom money is owed"<sup>226</sup> and "a person or entity with a definite claim against another, especially a claim that is capable of adjustment and liquidation".<sup>227</sup>

Cassim claims that the statutory merger provisions override the common law requirements for a delegation of an obligation. Consequently, a person claiming against the original obligor is deprived of the right to veto the transfer of an obligation when the obligor is substituted.<sup>228</sup> As an alternative, the Companies Act confers the right on 'all known creditors' to receive notice and invoke a court remedy.<sup>229</sup>

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<sup>222</sup> Companies Act 71 of 2008, s 116(1); Stein (2011) 288; Cassim *et al* (2012) 694.

<sup>223</sup> Companies Act 71 of 2008, s 116(1)(a) and regulation 89(2). Therefore, as mentioned from section 116(1)(a) and as provided for in regulation 89(2) of the Act, each of the merging companies are required to publish a notice of the merger to every known creditor of that company.

<sup>224</sup> Latsky (2014) 374.

<sup>225</sup> Companies Amendment Bill GN 1014 GG 33695.

<sup>226</sup> Hall M "Oxford South African Secondary School Dictionary" (2006) 141.

<sup>227</sup> Garner BA "Black's Law Dictionary" 8 ed (2004) 1114.

<sup>228</sup> Cassim 'The Introduction of the Statutory Merger in South African Corporate Law: Majority Rule offset by the Appraisal Right (Part 1)' (2008) 5.

<sup>229</sup> Companies Act 71 of 2008, s 116(1)(a).

Latsky asserts that the Companies Act does not intend to extend this right only to parties with claims sounding in money, while depriving those with claims for the performance of services or other obligations of their protection at common law, without also providing them with the statutory substitute. Therefore, all parties with contractual and delictual claims against a merging company should be treated as creditors whom are entitled to be given notice in terms of section 116(1) of the 2008 Companies Act, even if their claims do not sound in money.<sup>230</sup>

Section 116(1) of the Act is unique as it is the only provision that provides creditors the express right to intervene in a fundamental transaction.<sup>231</sup> Section 116(1)(b) and (c) of the 2008 Companies Act provides the following:

- (b) within 15 (fifteen) business days after delivery of a notice required by paragraph (a), a creditor may seek leave to apply to court for a review of the amalgamation or merger only on the grounds that the creditor will be materially prejudiced by the amalgamation or merger; and*
- (c) a court may grant leave contemplated in paragraph (a) only if it is satisfied that –*
  - (i) the applicant for leave is acting in good faith;*
  - (ii) if implemented, the amalgamation or merger would materially prejudice the creditor; and*
  - (iii) there are no other remedies available to the creditor.<sup>232</sup>*

As seen from the above, the 2008 Companies Act offers relief for objecting creditors whereby a creditor may seek leave to apply to a court for a review of the transaction within 15 business days after delivery of the notice of merger. However, an application may only be made on the grounds that the creditor will be materially prejudiced, thus imposing a heavy onus on the creditor to discharge.<sup>233</sup> A court may grant leave to a creditor to apply for review of the merger only on the basis that it is satisfied that (i) the applicant is acting in good faith; (ii) that the merger, if implemented, would materially prejudice the creditor; and (iii) that there are no other remedies available to the creditor.<sup>234</sup>

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<sup>230</sup> Latsky (2014) 374 and 375.

<sup>231</sup> Stein (2011) 288.

<sup>232</sup> Companies Act 71 of 2008, s 116(1)(b) - (c).

<sup>233</sup> Stein (2011) 288.

<sup>234</sup> Cassim *et al* (2012) 694.

The term '*materially prejudiced*' is not defined nor described in the 2008 Companies Act. In this regard, the term requires judicial interpretation to define its scope and limits.<sup>235</sup>

The requirement of notifying creditors of the merger agreement and the requisite waiting period of 15 business days have been criticized for adding a significant element of risk and substantial delay to the merger procedure. Furthermore, it has been criticized for the possibility of undermining the utility of the new merger procedure.<sup>236</sup> Davids *et al* argues that it is unclear why this requirement should be necessary as the board of directors of the constituent companies would already have satisfied the solvency and liquidity test, and the creditors would in any event have their claims secured against the company by an agreement establishing such interest between the creditor and the company.<sup>237</sup>

Nevertheless, where the creditors fail to object to the transaction within the requisite period, the merging companies may then proceed with implementation of the merger.<sup>238</sup> However, where the creditors make an application for review of the transaction, until the court has disposed all of the proceedings, only then may the parties to the merger agreement proceed with implementation of the merger.<sup>239</sup>

#### **2.2.3.5) Implementation of the merger**

The fifth and concluding step in the merger procedure is the implementation of the merger. Section 116(3) of the 2008 Companies Act provides that:

- (3) *A notice of amalgamation or merger must be filed after the transaction has satisfied applicable requirements set out in section 115, and –*
- (a) *after the time contemplated in section (1)(b), if no application has been made to the court in terms of that subsection; or*
  - (b) *in any other case –*
    - (i) *after the court has disposed of any proceedings arising in terms of subsection (1)(b) and (c); and*
    - (ii) *subject to the order of the court.*

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<sup>235</sup> Cassim *et al* (2012) 694.

<sup>236</sup> Davids *et al* (2010) 365.

<sup>237</sup> Davids *et al* (2010) 365.

<sup>238</sup> Davids *et al* (2010) 348.

<sup>239</sup> Cassim *et al* (2012) 694.

As envisaged from the above provision, the parties to the merger agreement are only allowed to proceed with the implementation of the merger once the transaction has satisfied all the applicable approval requirements as set out in section 115 of the 2008 Companies Act, and if no objecting creditors apply to court within the 15 day prescribed period.<sup>240</sup> However, where an objecting creditor does seek leave to apply to court for a review of the merger, the companies concerned may implement the merger only after the court has disposed of the creditor's application, and subject to the order of the court.<sup>241</sup>

Furthermore, to facilitate the implementation of the merger, a notice of merger must be filed with the Companies Commission.<sup>242</sup> Section 116(4) of the 2008 Companies Act provides the following information that is required in a notice of merger, *inter alia*:

- (4) A notice of amalgamation or merger must include –
- (a) confirmation that the amalgamation or merger –
    - (i) has satisfied the requirements of section 113 and 115;
    - (ii) has been approved in terms of the Competition Act, if so required by that Act;
    - (iii) has been granted the consent of the Minister of Finance in terms of section 54 of the Banks Act, if so required by that Act; and
    - (iv) is not subject to –
      - (aa) further approval by any regulatory authority; or
      - (bb) any unfulfilled conditions imposed by or in terms of any law administered by a regulatory authority; and
  - (b) the Memorandum of Incorporation of any company newly incorporated in terms of the agreement.<sup>243</sup>

This raises a red flag for intra-group mergers<sup>244</sup> that are required to satisfy the requirements of section 113 and 115 of the Act. According to section 113(4)(b) of the Companies Act, as a result of both the subsidiary and the holding company being merging companies, each company is required to take a special resolution in compliance with section 115 of the Companies Act.<sup>245</sup> Section 115(4) of the Act provides that the voting rights controlled by an 'acquiring party' must not be included

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<sup>240</sup> Cassim *et al* (2012) 695.

<sup>241</sup> Cassim *et al* (2012) 695.

<sup>242</sup> Davids *et al* (2010) 348; Cassim *et al* (2012) 695.

<sup>243</sup> Companies Act 71 of 2008, s 116(4).

<sup>244</sup> Intra-group mergers is defined as a merger between a holding and a subsidiary company.

<sup>245</sup> Latsky (2014) 377.

in the quorum of the meeting or have voted in support of the resolution.<sup>246</sup> An 'acquiring party' is defined in section 1 of the Companies Act as:

(1) A person who, as a result of the transaction, would directly or indirectly acquire or establish direct or indirect control or increased control over all or the greater part of a company, or all or the greater part of the assets or undertaking of the company.<sup>247</sup>

In light of the definition of 'acquiring party' established in section 1 of the Act, the position of intra-group mergers is puzzling as one would question what it would mean to acquire '*increased control*' highlighted in the provision if a company already has control of another in the sense of being able to exercise the majority of its voting rights as envisaged in section 2(2)(a) of the Companies Act.<sup>248</sup>

Although ambiguous, the provision clearly provides that the holding company acquires control of the greater part of the assets or undertaking of the subsidiary. For this reason, the holding company is barred from voting in respect of the resolution, making it impossible to comply with the requirement of the Act to take the resolution, as there are no other shareholders. Furthermore, it is impossible for the acquiring party to refrain from voting on the resolution if it is to be taken at all. As a result, the Companies Act is exceptionally vague as to the position of intra-group mergers.<sup>249</sup>

Perhaps the answer lies in the maxim *lex non cogit ad impossibilia aut inutilia*.<sup>250</sup> This principle would have an effect of excusing the parties from performing a requirement that is objectively impossible to perform lawfully. Although the principle is prevalent in the civil and criminal law context, it is not confined to any particular area of law, and there appears to be no reason why it is not also capable of application to the current company law regime where the 2008 Companies Act excludes the holding company from voting on the special resolution required to approve the merger.<sup>251</sup> As a result, the provision that should get preference is section 115(4)(b) which requires the special resolution to be taken and which the holding company should vote on the resolution, on the grounds that it will be excused from the requirement that an acquiring party may

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<sup>246</sup> Companies Act 71 of 2008, s 115(4).

<sup>247</sup> Companies Act 71 of 2008, section 1.

<sup>248</sup> Latsky (2014) 377;

<sup>249</sup> Latsky (2014) 377.

<sup>250</sup> Latsky (2014) 377. This provides that the law does not operate for an impossible purpose.

<sup>251</sup> Latsky (2014) 377 and 378.



not vote.<sup>252</sup> Should the legislature take account of this, agreements pertaining to intra-group mergers will not only satisfy the requirements of both section 113 and 115 of the Act, but it will also comply with section 116(4) of the Companies Act.

Should the notice of merger contain all the information required from the above and comply with section 116(4) of the Act, it must then be filed with the Companies Commissioner. This requirement is similar to other jurisdictions. In most American states, a merger becomes effective upon filing a Certificate of Merger with the office of the Secretary of State.<sup>253</sup> A similar method of implementing a merger has also been adopted by New Zealand and Canada.<sup>254</sup>

According to section 116(5), the Companies Commissioner is required to do the following upon receipt of the notice of amalgamation or merger:

- (5) *After receiving a notice of amalgamation or merger, the Commission must –*
- (a) *issue a registration certificate for each company, if any, that has been newly incorporated in terms of the amalgamation or merger agreement; and*
  - (b) *deregister any of the amalgamating or merging companies that did not survive the amalgamation or merger.*<sup>255</sup>

After receiving a notice of merger, the Commission is obligated to issue a registration certificate for each company that has been newly incorporated, and also deregister any of the merging companies that are not intended to survive the transaction established under the merger agreement.<sup>256</sup> Cassim *et al* provide that deregistration occurs without the need for any formal winding-up.<sup>257</sup> This is advantageous for the reason that instead of following the lengthy procedure of winding-up a company, the Companies Commission simply deregisters it, thus saving time and costs.

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<sup>252</sup> Latsky (2014) 377.

<sup>253</sup> Delaware General Corporation Law 2001, s 251(c); see also Revised American Model Business Corporation Act 1984, s 11.06(b).

<sup>254</sup> New Zealand Companies Act 105 of 1993, s 223 – 225; see also Canada Business Corporations Act 1985, s 185 and 186(a).

<sup>255</sup> Companies Act 71 of 2008, s 116(5).

<sup>256</sup> Stein (2011) 289; see also Davids *et al* (2010) 349.

<sup>257</sup> Cassim *et al* (2012) 695.

The merger between the constituent companies takes effect in accordance with, and subject to any conditions set out in the merger agreement.<sup>258</sup> Section 116(6)(b) provides the following:

(6) *An amalgamation or merger –*

*(b) does not affect any –*

- (i) existing liability of a party to the agreement, or of a director of any of the amalgamating or merging companies, to be prosecuted in terms of any applicable law;*
- (ii) civil, criminal or administrative action or proceeding pending by or against an amalgamating or merging company, and any such proceeding may continue to be prosecuted by or against any amalgamated or merged company; or*
- (iii) conviction against, or ruling, order or judgment in favour of or against, an amalgamating or merging company, and any such ruling, order or judgment may be enforced by or against any amalgamated or merged company.<sup>259</sup>*

Section 116(6)(b) of the Act attempts to ensure that the merger prejudices no stakeholder in any merging company.<sup>260</sup>

With regard to existing liabilities insinuated in section 116(6)(b)(i), Dickinson J held the following in the case of *R v Black & Decker Manufacturing Co.*<sup>261</sup>

*'The purpose is economic: to build, to consolidate, perhaps to diversify, existing businesses; so that through union there will be enhanced strength. It is a joining of forces and resources in order to perform better in the economic field. If that be so, it would surely be paradoxical if that process were to involve death by suicide or the mysterious disappearance of those who sought security, strength and above all, survival in that union. . . The end result is a coalesce to create a homogenous whole. The analogies of a river formed by the confluence of two*

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<sup>258</sup> Companies Act 71 of 2008, s 116(a); see also Cassim *et al* (2012) 695.

<sup>259</sup> Companies Act 71 of 2008, s 116(b); Stein (2011) 289, Stein holds that the words 'an' and 'any' in section 116(6)(b)(ii) and (iii) clearly indicate that each company that survives the amalgamation or merger is jointly and severally liable and responsible for the liabilities and obligations of every amalgamating or merging company that parties to the merger agreement.

<sup>260</sup> Stein (2011) 289.

<sup>261</sup> *R v Black & Decker Manufacturing Co* [1975] 1 SCR 441 (SCC).

*streams, or the creation of a single rope through the intertwining of strands have been suggested by others.*<sup>262</sup>

It is clear that Dickinson J envisaged the intended juridical nature of a merger. Cassim *et al* aver that the statutory merger provides for a simple, uncomplicated and effective procedure whereby two or more companies may merge their respective assets and liabilities, and vest it into the merged company.<sup>263</sup> Therefore, to ensure that the procedure is in harmony with the juridical nature of a merger, it does not affect the existing liability of any of the merging companies for criminal prosecution.<sup>264</sup>

#### **2.2.4) The effect of a merger transaction**

The 2008 Companies Act has made drastic alterations to the effect of a merger agreement. Prior to the new regime, the transfer of assets and liabilities was generally achieved by registration of immovable property, by delivery of movable assets and by delegation or assignment of liabilities.<sup>265</sup> However, the 2008 Companies Act provides that upon implementation of a merger agreement, such an agreement would have the following consequence in terms of section 116(7) of the 2008 Companies Act:

(7) *When an amalgamation or merger agreement has been implemented –*

- (a) *the property of each amalgamating or merging company becomes the property of the newly amalgamated, or surviving merged, company or companies; and*
- (b) *each newly amalgamated, or surviving merged company is liable for all of the obligations of every amalgamating or merged company, in accordance with the provisions of the amalgamation or merger agreement, or any other relevant agreement, but in any case subject to the requirement that each amalgamated or merged company must satisfy the solvency and liquidity test, subject to subsection (8), if it is applicable.*<sup>266</sup>

Upon the implementation of the merger, all of the assets and liabilities of the merging companies would vest, by operation of the law, in the merged company or companies.<sup>267</sup> This is deemed to be one of the key advantages of the merger procedure introduced by the 2008 Companies Act as companies may avoid the costs

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<sup>262</sup> *R v Black & Decker Manufacturing Co* [1975] 1 SCR 441 (SCC) 420 – 422.

<sup>263</sup> Cassim (2008) 20 SA Merc LJ 4; Cassim *et al* (2012) 677.

<sup>264</sup> Cassim (2008) 20 SA Merc LJ 4.

<sup>265</sup> Bouwman N 'New Roads for M&As' (2009) 9 *Without Prejudice* 34.

<sup>266</sup> Companies Act 2008, section 116(7).

<sup>267</sup> Davids *et al* (2010) 349.

and legal formalities generally required for the transfer of a business from one company to another, as well as the time associated to transfer assets such as intellectual or immovable property.<sup>268</sup> Therefore, when a company undergoes a merger, the vesting of its respective properties and obligations simply takes place by operation of the law, thus saving the company a large amount of costs and time when concluding the merger.<sup>269</sup>

This effect is limited to section 116(8) of the 2008 Companies Act, which expressly stipulates the following:

*(8) If, as a consequence of an amalgamation or merger, any property that is registered in terms of any public regulation is to be transferred from an amalgamating or merging company to an amalgamated or merged company, a copy of the amalgamation or merger agreement, together with a copy of the filed notice of amalgamation or merger, constitutes sufficient evidence for the keeper of the relevant property registry to effect a transfer of the registration of that property.*<sup>270</sup>

In view of the abovementioned provision, an exception to the principle of automatic transfer by operation of law applies in relation to any property that is registered in terms of a public regulation such as an immovable property.<sup>271</sup> Therefore, any immovable property that is registered in a public registry may automatically be registered in the name of the relevant merged entity upon presentation of the merger agreement and filed notice of merger.<sup>272</sup> Stein submits that section 116(8) of the Act should rather have referred to 'immovable property' as the word 'property' is used extensively throughout the Act and, although not defined, clearly means any asset, whether movable or immovable.<sup>273</sup>

Upon the implementation of the merger, section 116(7)(a) of the new Act provides that the '*property*' of each constituent merging company becomes the property of the newly merged, or surviving merged company, no matter what the case may be.<sup>274</sup> As

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<sup>268</sup> Davids *et al* (2010) 349.

<sup>269</sup> Companies Act 71 of 2008, s 116(7).

<sup>270</sup> Companies Act 71 of 2008, s 116(8).

<sup>271</sup> Cassim *et al* (2012) 682; Companies Act 71 of 2008, s 1, 'public regulation' is defined as any national, provincial or local government legislation or subordinate legislation, or any licence, tariff, directive or similar authorisation issued by a regulatory authority or pursuant to any statutory authority.

<sup>272</sup> Davids *et al* (2010) 349.

<sup>273</sup> Stein (2011) 290 and 291.

<sup>274</sup> Cassim *et al* (2012) 681.

mentioned above, although the term '*property*' is not expressly defined in the Act, it would seemingly, in this context, be interpreted in its wide sense to include all property, rights, powers and privileges.<sup>275</sup> Davids *et al* maintain that this would furthermore include both corporeal and incorporeal property.<sup>276</sup>

Moreover, in terms of section 116(7)(b), upon implementation of the merger agreement, the newly merged or surviving company is deemed to be liable for all of the obligations of every constituent companies to the merger agreement.<sup>277</sup> This is however subject to the requirements of section 113(1), and any provision of the merger agreement, or any other agreement.<sup>278</sup>

It is noteworthy that section 116(7) of the 2008 Companies Act deals with the transfer of '*property*' and '*obligations*'. However, there is no provision that exclusively deals with the cession of commercial agreements.<sup>279</sup> The qualification of the general rule that all liabilities of the merging companies are assumed by the company surviving the merger, which is subject to '*any other agreement*', is criticized for being potentially confusing and unfortunate.<sup>280</sup> Furthermore, although South Africa's statutory merger provisions are based on those of the United States and Canada, it appears in those jurisdictions that the above rule is one of the most controversial and uncertain aspects of their merger rule.<sup>281</sup> In the absence of this qualification, the cession of commercial agreements, to which the constituent companies were party to, would be a matter of interpreting the specific contracts implicated.<sup>282</sup>

Contractual rights and obligations of the disappearing company would in general vest in the surviving company automatically by operation of the law.<sup>283</sup> However, it is submitted that where an anti-transfer clause is attached to an agreement that specifically provides that the contract will not survive a statutory merger, such a clause would be effective to prevent the vesting of the contract in the surviving merged

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<sup>275</sup> Cassim *et al* (2012) 681.

<sup>276</sup> Davids *et al* (2010) 349.

<sup>277</sup> Cassim *et al* (2012) 681.

<sup>278</sup> Davids *et al* (2010) 349.

<sup>279</sup> Nicol B (2013) 25 *SA Merc LJ* 30.

<sup>280</sup> Davids *et al* (2010) 349.

<sup>281</sup> Kleitman Y 'Giving us an American headache' (2013) 13 *Without Prejudice* 20.

<sup>282</sup> Davids *et al* (2010) 350.

<sup>283</sup> Cassim *et al* (2012) 682.

company.<sup>284</sup> Kung holds that the common law generally favours free assignability of contractual rights. In light of the above, where an anti-transfer clause, which is also known as a *pactum de non cedendo* (hereafter, '*pactum*'), is utilised by parties to a merger agreement, such a clause would disregard the default rule of free assignability and prohibit the assignment or transfer of contractual rights and property.<sup>285</sup>

Contrary to the above, it was established in the case of *Paiges v Van Ryn Gold Mine Estates Ltd* (hereafter, '*Paiges*') that the debtor is required to show that he has an interest in the prohibition against the cession of contractual rights and property.<sup>286</sup> Therefore, if the debtor cannot show that he has an interest, the merging company may validly cede the contractual rights and property once the company has merged in terms of the merger agreement.

In contrast to what was held in the case of *Paiges*, Sunkel argues that our courts should recognise the *pactum* as valid regardless of the absence or presence of an interest. Sunkel holds that as the cornerstone of the principle of *pacta sunt servanda*<sup>287</sup>, the debtor is only required to show that the parties were *ad idem*.<sup>288</sup> Sunkel furthermore asserts that the interest requirement is insignificant in our law, yet at the same time, it is broad and vague for the reason that the debtor would always have interest in the identity of the company to which he is conducting a contract with.<sup>289</sup> Therefore, it is clear that the existence of the interest requirement in *Paiges* is effectively unconvincing authority.

On the basis that assumption would take place by operation of law and not by assignment or cession, a provision prohibiting assignment without consent would not prevent the merged companies from assuming rights and obligations under the contracts.<sup>290</sup> Furthermore, Nicol submits that a *pactum* will not be effective as it only envisages a prohibition on cession, which is a voluntary act of transfer, and does not envisage a prohibition on transfer by operation of law.<sup>291</sup> For this reason, even where

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<sup>284</sup> Nicol B (2013) 25 SA Merc LJ 31; Cassim *et al* (2012) 683.

<sup>285</sup> Kung S 'The reverse triangular merger loophole and enforcing anti-assignment clauses' (2009) 103 *Northwestern Univ LR* 1037 1043.

<sup>286</sup> *Paiges v Van Ryn Gold Mine Estates Ltd* 1920 AD 615.

<sup>287</sup> Sunkel K (2010) 464 – *pacta sunt servanda* is defined as the freedom of contract.

<sup>288</sup> Sunkel K (2010) 464.

<sup>289</sup> Sunkel K (2010) 464.

<sup>290</sup> Davids *et al* (2010) 350.

<sup>291</sup> Nicol B (2013) 25 SA Merc LJ 32 and 37.

a contract is expressly non-assignable according to its terms, it would nevertheless vest in the merged company by operation of the law, which is not prohibited by a *pactum*.<sup>292</sup>

Cassim holds that the assumption of assets or obligations in terms of section 116(7) of the 2008 Companies Act, subject to the requirements of '*any other agreement*', leaves a scope for the merging companies voluntarily to exclude certain assets and liabilities from the merger transaction, thus going beyond the basic juridical nature of a merger, as well as creating a scope for prejudice to the creditors of the disappearing company.<sup>293</sup> Furthermore, Davids *et al* argue that this qualification raises some doubt as to what assets or liabilities may be assumed in the merger by operation of law.<sup>294</sup> Consequently, this reference means that the merger transaction does not vitiate contracts. Therefore, where '*other agreements*' provide for the termination of agreements upon the implementation of a merger, such agreements in consequence shall terminate and neither the assets nor obligations will be assumed by the merged entity.<sup>295</sup>

Section 116(7) of the 2008 Companies Act is not intended to allow parties to contract out of the legal consequences of a merger, including the automatic assumption by the merged entity of all rights and obligations of the merging entities.<sup>296</sup> Therefore, if a company is party to a contract that provides that specified rights or obligations terminate if it engages in a merger, and the company subsequently enters into a merger, the consequences of termination of the rights or obligations are provided for as a matter of contract and the statute is not required to specify that the assumption of merging parties' obligations in a merger is '*subject to any other agreement*'.<sup>297</sup> The wording of section 116(7)(b) is somewhat ambiguous in this regard. For this reason, the legislature could have taken better steps to provide further clarification as to what is meant by making the assumption of obligations subject to '*any other agreement*'.<sup>298</sup>

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<sup>292</sup> Cassim (2008) 20 SA Merc LJ 5.

<sup>293</sup> Cassim (2008) 20 SA Merc LJ 6.

<sup>294</sup> Davids *et al* (2010) 350.

<sup>295</sup> Davids *et al* (2010) 350.

<sup>296</sup> Davids *et al* (2010) 350.

<sup>297</sup> Davids *et al* (2010) 350.

<sup>298</sup> Davids *et al* (2010) 350.

It is noteworthy that the 2008 Companies Act unequivocally states that the merged company or companies assume the obligations of the merging companies, but fails to specifically point out that the merged company or companies will automatically step into the shoes of the merging companies and acquire such rights or obligations, which is presumably the intention.<sup>299</sup>

On the basis that contractual rights are the property of the right holder, they are presumably covered by section 116(7)(a) and will therefore become the property of the merged company. However, the fact that the transfer of obligations under section 116(7)(b) is subject to certain qualifications, whereby the transfer of property under section 116(7)(a) is not, it may have been preferable to deal with the transfer of contractual rights and liabilities as a separate provision.<sup>300</sup> Davids *et al* emphasizes that this would specifically confirm that the merged company or companies would replace the merging companies as parties to whatever agreements the merging companies were party to by operation of law, and assume both the rights and obligations of the merging parties under those agreements.<sup>301</sup> This position was strongly supported by Brand JA in the case of *Tecmed (Pty) Ltd v Nissho Iwai Corporation*<sup>302</sup> where the court, with reference to *Absa Bank Limited v Van Biljon and Another*,<sup>303</sup> held that a merger transaction transferring all the rights and obligations of a merging entity has the effect that the merged entity steps into the shoes of the merging entity by operation of the law.<sup>304</sup>

Besides the aforementioned issue, there are undeniably a number of other issues that will arise in relation to the implementation of mergers that will need to be regulated, or dealt with in practice, and consequential amendments to a variety of different legislation will be required.<sup>305</sup> Despite the uncertainty in the regulation of the implementation of mergers, the legislators intention in introducing sections 116(6), (7) and (8) in the 2008 Companies Act are to make the implementation of a merger as seamless, quick and cheap as possible, but without prejudicing the legal rights or

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<sup>299</sup> Davids *et al* (2010) 351.

<sup>300</sup> Davids *et al* (2010) 351.

<sup>301</sup> Davids *et al* (2010) 351.

<sup>302</sup> *Tecmed (Pty) Ltd v Nissho Iwai Corporation* 2011 (1) SA 35 (SCA).

<sup>303</sup> *Absa Bank Limited v Van Biljon and Another* 2000 (1) SA 1163(W) at para 1169H-J.

<sup>304</sup> *Tecmed (Pty) Ltd v Nissho Iwai Corporation* 2011 (1) SA 35 (SCA) at para 21.

<sup>305</sup> Davids *et al* (2010) 351, Davids *et al* holds that the Deeds Registries Act 47 of 193, which regulates the registration and transfer of immovable property, will need to be amended.



removing the legal obligations of stakeholders, particularly creditors. Ultimately, the provisions in the Act dealing with the implementation of mergers will undoubtedly result in significant cost and time savings, especially in large and complex transactions.<sup>306</sup>

Should the shareholders approve a fundamental transaction, any person to whom assets are to be transferred may, in terms of section 115(9) of the 2008 Companies Act, apply to a court for an order to give effect to the transaction.<sup>307</sup> An order by the court would effect, *inter alia*:

- (i) *the transfer of the relevant undertaking, assets and liabilities;*
- (ii) *the allotment and appropriation of any relevant shares or similar interests;*
- (iii) *the transfer of shares from one person to another;*
- (iv) *the dissolution without winding-up of a company, as contemplated in the transaction;*
- (v) *incidental, consequential and supplemental matters that are necessary for the effectiveness and completion of the transaction; or*
- (vi) *any other relief necessary or appropriate to give effect to and properly implement an amalgamation or merger.*<sup>308</sup>

The abovementioned mechanism permits a party to a transaction to enforce it if the other party refuses to give effect to the merger agreement after shareholder approval has been obtained.<sup>309</sup>

### **2.3) CONCLUDING REMARKS RELATING TO MERGER TRANSACTIONS**

The merger transaction is not only a progressive and modernised procedure, but it is also a relatively straightforward, versatile and flexible mechanism which provides parties to the transaction great latitude to decide on the conditions of the merger agreement, thus giving companies the freedom to structure the merger transaction in a manner that best meets their requirements.

Not only does the 2008 Companies Act place little limitation on the content of the agreement, but it too provides a simple and efficient method of combining assets and liabilities of the merging companies by operation of law. The new merger procedure consequently makes the administration involved in acquiring a company significantly

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<sup>306</sup> Stein (2011) 291.

<sup>307</sup> Cassim *et al* (2012) 695.

<sup>308</sup> Cassim *et al* (2012) 695.

<sup>309</sup> Davids *et al* (2010) 352.

simpler than the more arduous process involved in a traditional sale of business by preventing companies from complying with lengthy formalities and incurring costs when implementing a merger.

## **CHAPTER 3 – PROTECTION MECHANISMS AND REMEDIES PROVIDED BY THE 2008 COMPANIES ACT**

### **3.1. INTRODUCTION**

When the legislator introduced the improvements to the way fundamental transactions are regulated in South Africa, much recognition was also given to minority shareholders who disagreed with a merger and directors bound to the interference of courts when making decisions, with the benefit of hindsight, for the company.

The 2008 Companies Act introduced new and more effective remedies for minority shareholders as opposed to the 1973 Companies Act, including the derivative action, an order to have a director declared a delinquent, an order for relief from oppressive or unfairly prejudicial conduct of the company, a declaratory order and appraisal rights.<sup>310</sup>

In addition to the above, the legislature also took the opportunity to afford directors wider protection against liability for poor business decisions or honest errors of judgement by adopting the US-style Business Judgement Rule (hereinafter 'BJR' or 'rule') into the 2008 Companies Act.<sup>311</sup>

The Act offers many protection mechanisms and remedies to both directors and shareholders of the companies when embarking on a merger transaction. However, for the purpose of chapter 3, consideration will be made on the appraisal right and the BJR, the two main remedies provided to minority shareholders and directors.

### **3.2) APPRAISAL RIGHTS FOR SHAREHOLDERS**

It is an illustrious norm that companies are autonomous organisations where the majority can subject the minority to its rule. This is evident as the affairs of a company, apart from business management decisions, are commonly decided by the majority of

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<sup>310</sup> Cassim *et al* (2012) 25.

<sup>311</sup> Cassim *et al* (2012) 20.

shareholder votes in that company.<sup>312</sup> This position was endorsed in the case of *Sammel v President Brand Gold Mining Co Ltd*<sup>313</sup> where Trollop JA held the following:

*“By becoming a shareholder in a company a person undertakes by his contract to be bound by the decisions of the prescribed majority of shareholders, if those decisions on the affairs of the company are arrived at in accordance with the law, even where they adversely affect his own rights as a shareholder. The principle of the supremacy of the majority is essential to the proper functioning of companies.”*<sup>314</sup>

The introduction of the statutory merger is the manifestation of the principle that majority rule suffices to fundamentally change the nature of the company, as well as the nature of the investment of all shareholders, without the need for any court approval of the merger.<sup>315</sup> The lack of judicial involvement may potentially subject the minority shareholders to ill treatment and oppression. It is only in exceptional circumstances that the courts may set a statutory merger aside.<sup>316</sup> A clear solution for these shareholders would be to sell their shares. For this reason, there was an exigency upon the legislature to recognise such circumstances and give respite to these dissenting shareholders.

To avoid locking in minority shareholders in inefficient companies, the 2008 Companies Act introduced a fundamentally new concept into our law, namely the appraisal rights.<sup>317</sup> The appraisal right, which is a prime protective measure for shareholders, was inspired by a similar protection provided in American corporate law, which effectively grants a put option to dissenting shareholders.<sup>318</sup> This remedy has recently been adopted in Canada and New Zealand.<sup>319</sup> It is noteworthy that the

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<sup>312</sup> Druker D ‘The Merits and Demerits of the Appraisal Remedy in the Context of Statutory Mergers and Amalgamations’ (2011) 1 JSR 6.

<sup>313</sup> *Sammel v President Brand Gold Mining Co Ltd* 1969 3 SA 629 (A).

<sup>314</sup> *Sammel v President Brand Gold Mining Co Ltd* 1969 3 SA 629 (A) 678.

<sup>315</sup> Cassim (2008) 20 SA Merc LJ at 20.

<sup>316</sup> Companies Act 71 of 2008, s 115(7). The court may set aside the merger on the grounds that the resolution was manifestly unfair to the holders of the company’s securities; or the vote was materially tainted.

<sup>317</sup> Stein p298

<sup>318</sup> Davids *et al* (2010) 352;

<sup>319</sup> Cassim *et al* (2008) 796.

appraisal right remedy was not adopted as a wholesale, but has been tailored to the South African context.<sup>320</sup>

The appraisal right, which is inherent in section 164 of the 2008 Companies Act, serves as an exit mechanism to dissenting shareholders who fail to approve of a merger with the right to have their shares bought out by the company in cash at a price reflecting the fair value of the shares. In essence, the appraisal right provides minority shareholders a means of challenging the adequacy of the consideration that they have received for their shares.<sup>321</sup>

In the context of a merger, the appraisal right is not a general remedy for shareholders as it is only triggered by way of notice to shareholders of a meeting to consider adopting a resolution to merge.<sup>322</sup>

There are three fundamental objects for the introduction of appraisal rights. Firstly, it facilitates the market for mergers. Secondly, it provides liquidity to dissenting shareholders and finally, it serves as a check on opportunism by the directors and the controlling shareholders.<sup>323</sup> Ultimately, the appraisal remedy was introduced to reconcile the need to provide the majority shareholders the prerogative to make drastic changes to the enterprise, with the need to protect the minority against being involuntarily dragged along into a radically restructured business which it has no confidence in.<sup>324</sup>

The legislature's formal recognition of the appraisal rights of dissenting shareholders in a merger impliedly acknowledges that a merger has both considerable and far-reaching consequences for the shareholders of the constituent companies.<sup>325</sup> This is clear, as the nature of both the merging companies and the investments of the

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<sup>320</sup> Davids *et al* (2010) 352. This is clear as the 2008 Companies Act does not adopt the Delaware 'market out' which provides that appraisal rights are not available if target company shareholders are receiving only publicly traded stock in consideration for their shares.

<sup>321</sup> Stein p299; Cassim *et al* 698; Davids *et al* (2010) 352.

<sup>322</sup> Companies Act 71 of 2008, s 164 (2) (b); Beukes HCJ 'An Introduction to the Appraisal Remedy in the Companies Act 2008: Standing and the Appraisal Procedure' (2010) 22 SA Merc LJ at 176; Cassim *et al* (2008) 796.

<sup>323</sup> Cassim (2008) 20 SA Merc LJ at 159.

<sup>324</sup> Cassim (2008) 20 SA Merc LJ at 159.

<sup>325</sup> Cassim (2008) 20 SA Merc LJ at 19.

shareholders will be subject to alteration, whilst their rights as shareholders could also possibly change.<sup>326</sup>

Notably, the merger procedure is not limited to transactions whereby both sets of shareholders of the constituent companies continue to participate as shareholders in the surviving merged company. Instead, the consideration presented to shareholders of the disappearing company may consist of other securities, property, or cash.<sup>327</sup> Therefore, it appears that the shareholders of the constituent companies do not have the right to insist on remaining as shareholders of the surviving company, but may instead be disinvested of their interests in the company and be left only with a cash consideration.<sup>328</sup>

Although South African company law has always provided protections and remedies to shareholders who have been oppressed or wronged in some way, the appraisal right remedy is distinctive in nature for the reason that it is a 'no-fault' remedy. Accordingly, as opposed to the other protections and remedies inherent in the 2008 Companies Act, the appraisal right mechanism requires no wrongdoing on the part of the majority shareholders or the company for the disgruntled minority shareholder to be afforded the relief sought.<sup>329</sup>

In view of the fact that the affairs of a corporation is commonly decided by the majority of shareholder votes in that company, protection by way of the appraisal right is afforded to disgruntled shareholders who disapprove of the merger.<sup>330</sup> These dissenting shareholders are entitled to exercise their appraisal rights provided the following requirements in terms of the 2008 Companies Act have been satisfied within the stipulated time periods.

Initially, when a company gives notice to shareholders of a meeting to consider adopting a resolution to effect a merger, the dissatisfied or dissenting shareholders are required to give the company a written notice objecting to the resolution, prior to the shareholders meeting where the relevant resolution is to be voted on.<sup>331</sup> This is

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<sup>326</sup> Cassim (2008) 20 *SA Merc LJ* at 19.

<sup>327</sup> Cassim (2008) 20 *SA Merc LJ* at 19.

<sup>328</sup> Cassim (2008) 20 *SA Merc LJ* at 19.

<sup>329</sup> Yeats J 'Putting Appraisal Rights into Perspective' (2014) *Stell LR* at 336.

<sup>330</sup> Cassim (2008) 20 *SA Merc LJ* at 19.

<sup>331</sup> Companies Act 71 of 2008, s 164(2); Cassim *et al* page 800.

one of the essential prerequisites as a failure by a shareholder to submit a written notice of objection to the company may preclude him from exercising his appraisal rights.<sup>332</sup> As a result of appraisal demands constituting a potential drain on the cash resources of the company, the underlying object of a written notice objecting to the resolution is to alert the company to the number of dissenters or dissatisfied shareholders, thereby not only enabling the company to estimate the amount of the cash payment that will be required upon appraisal, but also providing a scope for the board of directors to rethink its strategy and possibly revoke the adopted resolution where large numbers of minority shareholders indicate their intention to dissent.<sup>333</sup>

Once a resolution to merge is proposed for the approval at the shareholders meeting, the dissatisfied or dissenting shareholders are required to vote against the resolution.<sup>334</sup> If the resolution to merge is adopted, within ten business days subsequent to such adoption, the company is obligated to advise the objecting shareholders who gave the company a written notice of objection, and who has neither withdrawn that notice nor voted in favour of the resolution, by means of a notice confirming the fact that it was adopted.<sup>335</sup>

After the adoption of the proposed merger, should the dissenting shareholders wish to opt out of the company and be paid the fair value for their shares, they would have 20 days after receiving a notice of the merger to make this demand.<sup>336</sup> However, if the shareholder does not receive such notice, the shareholder will be entitled to make a demand within 20 business days after learning that the resolution has been adopted.<sup>337</sup>

The dissenting shareholders are required to comply meticulously with each procedural step inherent in section 164 of the 2008 Companies Act in order to exercise their appraisal rights. This renders the appraisal procedure a potential minefield for dissenting shareholders, as it is not only complex and technical, but it involves a number of specified notices, each coupled with a prescribed time limit for

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<sup>332</sup> Cassim *et al* page 800.

<sup>333</sup> Companies Act 71 of 2008, s 164(9)(c); Cassim *et al* page 800.

<sup>334</sup> Companies Act 71 of 2008, s 164(5)(c).

<sup>335</sup> Companies Act 71 of 2008, s 164(4); Cassim *et al* page 801; Beukes (2010) at 176.

<sup>336</sup> Companies Act 71 of 2008, s 164(7)(a).

<sup>337</sup> Companies Act 71 of 2008, s 164(7)(b).

completion.<sup>338</sup> The inherent imbalance in the appraisal procedure thus operates in favour of the company and severely against the minority shareholders.<sup>339</sup> While the underlying purpose of the procedural steps may be worthy in promoting and encouraging settlement between the company and the dissenters without resorting to judicial appraisal, the balance drawn by the Companies Act between the dissenting minority and the company has to be adjusted by providing greater latitude for shareholder compliance with its procedural obligations.<sup>340</sup> This balance can be achieved by giving courts discretionary power to extend the prescribed time limits for a dissenting shareholder to comply with prescribed procedural steps; or by interpreting the shareholder's procedural obligations as flexibly and as leniently as possible so as to excuse the lack of strict compliance by a shareholder despite a genuine attempt by it to comply with the prescribed procedure.<sup>341</sup>

Should the dissenting shareholder demand payment for his shares, the shareholder will have no further rights in respect of its shares other than its right to receive the fair value for the shares since the shareholder in his own accord elected to opt-out of the company.<sup>342</sup> This is highly unconventional as the fair value is paid only at the end of the appraisal proceedings. Therefore, until the conclusion of the appraisal proceedings, the shareholder's investment is frozen and the shareholder is deprived of the use of his or her funds.<sup>343</sup> It is noted that the American Model Business Corporation Act and the New Zealand Companies Act require the company to pay in cash a provisional amount, being the company's estimate of the fair value of the relevant shares.<sup>344</sup> If applied in South Africa, this would give the dissenting shareholder the immediate use of its funds pending the outcome of the arbitration proceeding to determine the fair value at the judicial appraisal proceedings.<sup>345</sup> Although beneficial to dissenters expecting their investments without experiencing any

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<sup>338</sup> Cassim (2008) 20 SA Merc LJ at 159 and 160.

<sup>339</sup> Cassim M 86 at 807-8.

<sup>340</sup> Cassim (2008) 20 SA Merc LJ at 165.

<sup>341</sup> Cassim (2008) 20 SA Merc LJ at 165; Wertheimer B 'The shareholders' appraisal remedy and how courts determine fair value' (1998) 47 *Duke Law Journal* at 709, Wertheimer refers to this solution as a statutory 'harmless error rule' or 'substantial compliance defence'.

<sup>342</sup> Davids *et al* (2010) 352; Once the dissenting shareholder has made such demand and complied with all the requirements in section 164 of the 2008 Companies Act, the shareholder ceases all its rights to those shares and would be deprived from his or her rights to future dividends as well as voting rights.

<sup>343</sup> Cassim *et al* (2012) 808.

<sup>344</sup> American Model Business Corporation Act, s13.24; New Zealand Companies Act, s 112(4).

<sup>345</sup> Cassim (2008) 20 SA Merc LJ at 166.

delays, this will be impractical as the 2008 Companies Act provides for three circumstances where the shareholder's rights are reinstated, even after making a demand: firstly, where the dissident withdraws the demand before the company makes an offer, or allows an offer made by the company to lapse; secondly, where the corporation fails to make an offer and the shareholder withdraws the demand; and thirdly, the company approves by special resolution to revoke the resolution that gave rise to the shareholder's appraisal right.<sup>346</sup>

Once such demand is made, the company is then obligated to send a written offer to each dissenting shareholder to acquire the value for his or her share that the board of directors deems fair, and provide a statement to the shareholders establishing how the value was determined.<sup>347</sup>

According to section 164(16) of the 2008 Companies Act, the fair value of the shares must be determined at the date of, and the time immediately preceding, the adoption of the resolution which gave rise to the appraisal.<sup>348</sup> However, this does not provide an adequate guidance on how to determine the fair value. As a result, it is unclear how companies will go about determining the fair value for a dissenting shareholder's shares. It was held in the case of *Ford Motor Company of Canada Ltd v Ontario Municipal Employees Retirement Board* that the rules under the appraisal remedy should be interpreted so that companies are encouraged to make a true fair value offer, not an offer premised on the companies' view as to the minimum value that might be set.<sup>349</sup> The Act is silent on the exact method of valuation, thus creating a lack of certainty that is bound to give rise to a fruitful ground for disputes between companies and shareholders.<sup>350</sup> Druker submits that although the lack of clarity may possibly lead to increased litigation, it can be argued that the failure of the legislature to provide a calculation in the 2008 Companies Act is in fact not a shortcoming of the Act as the determination of value varies depending on the type of business which the company carries on, the current economic conditions and other factors.<sup>351</sup>

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<sup>346</sup> Beukes (2010) at 187.

<sup>347</sup> Druker (2011) 10.

<sup>348</sup> Companies Act 164(16).

<sup>349</sup> *Ford Motor Company of Canada Ltd v Ontario Municipal Employees Retirement Board* 36 OR (3d) 384 (Ont CA) at 401.

<sup>350</sup> Druker (2011) 10.

<sup>351</sup> Druker (2011) 11.



Should a dispute arise regarding the fair value of the shares, the dissenting shareholders are entitled to apply to court for a judicial determination of the fair value of the relevant shares.<sup>352</sup> To assist the court in making such determination, section 164(15)(c) of the 2008 Companies Act provides a mechanism for the court to obtain the expertise necessary to make a determination by providing the court with discretion to appoint an appraiser.<sup>353</sup> The court will then assess the fair value at the time immediately before the relevant resolution was adopted and decide on the matter, as well as make an order as to what constitutes fair value for the shares.<sup>354</sup>

As the leading remedy for dissenting shareholders in a merger, the effectiveness of the appraisal remedy is somewhat diminished by its procedural flaws. Although contentious as a form of protection, the appraisal remedy is a welcomed mechanism for protecting the interests of both companies and dissenting shareholders, and thus unique to the South African legislation.<sup>355</sup> The appraisal remedy allows for the company to make major corporate decisions without being hindered by a small fraction of shareholders, whilst at the same time it increases minority shareholder protection by providing a dissenting shareholder with a mechanism to opt out instead of being forced to pursue a decision of the majority that he opposes.<sup>356</sup> It is thus evident that whilst there are some difficulties with regard to the exercise of this remedy, the difficulties fail to undermine the benefits created by the statutory merger, and is not likely to hinder merger activity.<sup>357</sup>

### **3.3) BUSINESS JUDGEMENT RULE**

It is well known that companies are juristic persons that exist separately from its management and shareholders.<sup>358</sup> As a result of companies not being able to act on its own, it conducts its mergers through representatives such as the board of directors who are entrusted with the management of the company's affairs.<sup>359</sup> It is thus crucial that the directors' executive powers are somehow limited in order to ensure that control is exercised over the board in the interest of the company, its creditors, and more

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<sup>352</sup> Companies Act 71 of 2008, s 164(14); Cassim (2008) 20 SA Merc LJ at 160.

<sup>353</sup> Yeats J 'Putting Appraisal Rights into Perspective' (2014) *Stell LR* at 334.

<sup>354</sup> Companies Act 71 of 2008, s 164(16) and s 164(15)(c)(ii).

<sup>355</sup> Cassim (2008) 20 SA Merc LJ at 175 and 176.

<sup>356</sup> Druker (2011) 21.

<sup>357</sup> Druker (2011) 21.

<sup>358</sup> *Hulse-Reutter v Godde* 2001 4 SA 1336 (SCA) 1346A-B.

<sup>359</sup> Havenga 'Corporate Opportunities: A South African Update (Part 1)' 1996 8 SA Merc LJ 66.

importantly, the shareholders.<sup>360</sup> In light of this, the South African corporate law seeks to impose control on directors who are vested with authority to implement mergers on behalf of the company.<sup>361</sup>

The standards of directors' conduct have been a central issue throughout the development of corporate law.<sup>362</sup> In light of the collapse of several large national and international corporations, notably the Enron group of companies in the United States of America (US) and the Fidentia scandal in South Africa, the public eye has increasingly fallen on the directors to perform their functions honestly and with the highest level of integrity.<sup>363</sup> In order to refrain directors' from failing to conform to the standard of care the company's stakeholders expect of them and to protect the companies' interests, there has been a need to reinforce rules and principles of good corporate governance.<sup>364</sup>

As a result of the abovementioned trend being observed, the 2008 Companies Act introduced a multitude of changes within South African company law.

In addition to the newly introduced statutory merger, the Act also partially codified the law regarding director's duties with the aim of making the law more accessible.<sup>365</sup> Initially, the 1973 Companies Act failed to clearly set out the duties of directors. As a result, courts were forced to seek the content of these duties in the common law.<sup>366</sup> However, the 2008 Companies Act sets out the director's duties by conferring on the board of directors a new statutory power and duty to manage the affairs of the company.<sup>367</sup>

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<sup>360</sup> Kennedy-Good S and Coetzee L 'The Business Judgement Rule (Part 1)' 2006 *Obiter* 63.

<sup>361</sup> Kennedy-Good and Coetzee (2006) 63.

<sup>362</sup> Naidoo R 'Corporate Governance: An Essential Guide for South African Companies' 2ed (2009) LexisNexis 2.

<sup>363</sup> Makuta E 'Towards Good Corporate Governance in State-Owned Industries: The Accountability of Directors' (2009) 3 *MLJ* 58; Matsimela R 'The Business Judgement Rule in South African Company Law: A miss or hit?' (2011) 1 *Company Law Hub Journal of Student Research* 10; Cassidy J 'Models for Reform: The Directors' Duty of Care in a Modern Commercial World' (2009) 20 *Stell LR* 373.

<sup>364</sup> Olivier S 'Good Corporate Governance in South Africa' (2012) available at [http://www.communicate.co.za/blog/Communicate\\_Blog/post/Good\\_Corporate\\_Governance\\_in\\_South\\_Africa/](http://www.communicate.co.za/blog/Communicate_Blog/post/Good_Corporate_Governance_in_South_Africa/) (accessed on 14 January 2016).

<sup>365</sup> Ahern D 'Directors' duties, dry ink and the accessibility agenda' (2012) 128 *Law Quarterly Review* 114.

<sup>366</sup> Cassim *et al* (2012) 507.

<sup>367</sup> Companies Act 71 of 2008, s 66(1). This is subject to the company's Memorandum of Incorporation.

In many respects, by providing directors with statutory duties, the 2008 Companies Act has created a wider base of potential liability for directors, whilst simultaneously providing directors wider protection against liability for poor business decisions or honest errors of judgement in implementing a merger by introducing the US-style BJR into South Africa company law.<sup>368</sup> The BJR is considered to be a rule of restraint that prevents a court from interfering in honest and reasonable business decisions of the company.<sup>369</sup>

Although the BJR is beneficial to directors, and even though many commentaries contend that it may be beneficial to companies, it is clear that it comes with many uncertainties which the South African company law should be aware of. Furthermore, it is noteworthy that the BJR usurps the function of the courts, a main forum for resolving disputes between parties, from intruding in the director's function in corporate decision making. This issue is highly significant as this may have harsh consequences on the companies wishing to claim from directors for their failure to exercise their duties when implementing a merger with the necessary care and skill.

As a result of the legislator adopting an American device into the South African corporate law, an analysis will be made surrounding the origin of the BJR with reference to the United States. Subsequently, a brief examination will then be made surrounding the development of the BJR in South Africa.

### **3.3.1) Origin of the Business Judgement Rule**

The BJR is deemed to be a mechanism which protects directors against the ramifications of honest business mistakes, and thus from liability to the company for losses resulting from poor decision making.<sup>370</sup> This protective mechanism consists of a rebuttable presumption that in making business decisions, the directors of a company have acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company.<sup>371</sup> Therefore, it addresses

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<sup>368</sup> Van der Linde K 'The personal liability of directors for corporate fault – An Exploration' (2008) 20 *SA Merc LJ* 441.

<sup>369</sup> Cassim *et al* (2012) 563.

<sup>370</sup> E Jones 'Directors' Duties: Negligence and the Business Judgement Rule' (2007) 19 *SA Merc LJ* 329.

<sup>371</sup> Jones (2007) 329.

the issues of both the honesty of directors and, to a limited extent, whether the directors has breached the duty of care.<sup>372</sup>

The BJR has its existence firmly entrenched in the state of Delaware and is to be found in cases over the past 160 years. It is a principle that has been a cornerstone of American corporate law jurisprudence since the early 19<sup>th</sup> Century.<sup>373</sup>

This protection mechanism is deemed to be a tool of judicial review that has been developed in the US as a common law rule relating to the directors' duty of care.<sup>374</sup> Although the rule has been in existence for a long period of time, it has been described as one of the least understood concepts in the entire corporate law sphere.<sup>375</sup>

The main objective of the BJR is to limit litigation and judicial scrutiny in relation to decisions that are taken within the business sector. In the case of *Aronson v Lewis*, Moore J confirmed this by submitting that the rule entails that, if a decision was made in good faith and it lacked fraudulent motive, then the director is protected from liability and its business decision from judicial review unless the director was grossly negligent in making poor business decisions.<sup>376</sup>

However, the American legislature has created the BJR to serve numerous purposes. Business decisions generally entail risks that not only affect the company, but also its shareholders. Therefore, without the mechanism, directors may become exceptionally cautious when carrying out their functions as bad decision-making could expose them to personal liability. This could be prejudicial to the company as risk-taking plays an important role in succeeding in the corporate world which could possibly place the company in a better position than before the decision was taken. The mechanism thus encourages risk-taking activities by the directors.<sup>377</sup>

Although judges have legal qualifications and experience in the field of legal practice, they are ill-equipped to second-guess business decisions. The motive for this is that

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<sup>372</sup> Jones (2007) 329.

<sup>373</sup> Kennedy-Good and Coetzee (2006) 64.

<sup>374</sup> Lee A 'Business Judgement Rule: Should South African Corporate Law follow the King Reports Recommendation?' (2005) 1 *University of Botswana Law Journal* 57.

<sup>375</sup> McMillan L 'The Business Judgement Rule as an Immunity Doctrine' (2013) *William and Mary Bus.L.Rev* 526.

<sup>376</sup> *Aronson v Lewis*, 473 A.2d 805, 812 (Del. 1984).

<sup>377</sup> Lee (2005) 53.

economics and business practice are not the judge's areas of expertise.<sup>378</sup> Furthermore, it was held in the case of *Sinclair Oil Corp v Levien* that a court will not impose its own views upon those of the directors if their decision can be attributed to any rational purpose.<sup>379</sup> In other words, where a board undertakes a suitable decision-making process, unless it constitutes fraud or it is deemed to be *ultra vires*, the court will not apply an objective reasonableness standard to examine the acumen of the business decision.<sup>380</sup> Therefore, the rule was implemented to avoid judicial second-guessing and thus prohibit unwarranted scrutiny of the decision taken by the directors concerned.<sup>381</sup>

It is clear from the aforementioned that the BJR is widely entrenched in American corporate law jurisprudence and that its main function is to serve as a safe harbour for directors from liability for claims made against them because of errors of judgement or business decisions that have adversely affected the company.<sup>382</sup>

The most interesting illustration of how the rule is utilised as a safe harbour for directors from liability is to be found in the case of *Shlensky v Wrigley* where the defendant brought a derivative action against the directors to claim damages for loss of revenue. The action stems from the renowned Wrigley Field, owned by Chicago Cubs, operating without lights and thus resulting in poor attendance at home games. Sullivan J held that the director's decision not to install lights at the Wrigley Field was protected by the business judgement rule and that it would not interfere with honest business judgements of the directors unless there was a presentation of fraud, illegality or conflict of interest.<sup>383</sup> The directors' decision not to install the lights was found to be neither irrational nor motivated by personal interests and the action was therefore successfully fended off.<sup>384</sup>

The *Shlensky v Wrigley* case presents a classic depiction of how the BJR is applied in the US. However, it is notable that the rule was applied on a case-by-case basis.

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<sup>378</sup> Kennedy-Good and Coetzee (2006) 65.

<sup>379</sup> *Sinclair Oil Corp v Levien*, 280 A.2d 717, 719-20 (Del. 1971).

<sup>380</sup> 'Corporate Governance and Fiduciary Duties' available at <http://apps.americanbar.org/buslaw/newsletter/0026/materials/46.pdf> (accessed on 19/0915) 6.

<sup>381</sup> Kennedy-Good and Coetzee (2006) 65.

<sup>382</sup> Lee (2005) 52.

<sup>383</sup> *Shlensky v Wrigley* 237 NE 2d 776 (1968 App Ct of Ill).

<sup>384</sup> *Shlensky v Wrigley* 237 NE 2d 776 (1968 App Ct of Ill).

There were two attempts in America to codify the BJR. The first was by the Committee on Corporate Laws of the Section of Business Law of the American Bar Association (ABA), and the second attempt was by the American Law Institute (ALI). Both committees failed to reach a consensus in respect of a formulation of the rule and thus agreed to leave the rule uncoded as it was contended that the rule is a doctrine that is well-founded within the common law, which could be interpreted and applied on a case-by-case basis.<sup>385</sup>

It is clear that the BJR was developed by the American judiciary to not only protect the directors from personal liability for decisions made in their capacity, but it was also developed to ensure sustainability within the company by ensuring that companies are embedded on good corporate governance.

Notwithstanding the abovementioned intentions in developing the BJR, there is a significant number of States in America where the rule has come under attack.<sup>386</sup> It also appears that there exists a trend in American case law toward the dilution of the BJR's protection in which courts rendered the rule inapplicable to bank directors,<sup>387</sup> intimidated directors,<sup>388</sup> and uninformed directors.<sup>389</sup> Furthermore, not only has America failed to codify the BJR twice, no legislation imposing the rule has been implemented in most federal states in America, except for California which was codified in section 309 of the Corporations Code.<sup>390</sup> Despite the controversy surrounding the BJR, it is noteworthy that the American creature has influenced the corporate law globally.

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<sup>385</sup> Kennedy-Good and Coetzee (2006) 73.

<sup>386</sup> LaCroix K 'The Business Judgement Rule Under Attack' (2014) *Director and Officer Liability* available at <http://www.dandodiary.com/2014/01/articles/director-and-officer-liability/guest-post-the-business-judgment-rule-under-attack/> (accessed on 22/01/2016).

<sup>387</sup> *FDIC v. Lauder milk*, 2013 U.S. Dist. LEXIS 166924 (N.D. Ga., Nov. 25, 2013). The district court in Georgia held that the BJR should not apply in a lawsuit by the Federal Deposit Insurance Corporation against directors of a failed bank.

<sup>388</sup> *New Jersey Carpenters Pension Fund v. Info GROUP, Inc.* 2011 Del. Ch. LEXIS 147 (Del. Ch., Sept. 30, 2011). The court found the BJR inapplicable to the conflicted director whom intensified his efforts to sell the company to address his personal cash liquidity crisis.

<sup>389</sup> *Official Committee of Unsecured Creditors v. Baldwin*, 2011 U.S. App. LEXIS 19312 (3d Cir., Sept. 21, 2011). The Appeal court ruled that the District court had improperly granted a motion for summary judgement in favour of the directors based on the BJR, notwithstanding the directors' apparent diligence.

<sup>390</sup> 'The California Business Judgement Rule' available at <http://www.nossaman.com/CaliforniaBusinessJudgementRule> (accessed on 27/09/2015).

### 3.3.2) Introduction of the Business Judgement Rule into South African Corporate Law

South African courts have on a few occasions made it clear that directors are not liable for mere errors of judgment.<sup>391</sup> This was confirmed in the case of *Levin v Feld and Tweeds Ltd* where Van Winsen AJ held that it is not the duty of the court to usurp the functions of the directors and to consider what was best for the companies from the business point of view.<sup>392</sup> It is thus clear that the BJR has influenced South African courts a long time ago.

In March 2002, the King Report on Corporate Governance recommended that an investigation should be held to determine whether it is necessary to enact a statutory BJR in South Africa.<sup>393</sup> The recommendation came amidst a growing concern that in a new era of corporate law, there would be a greater tendency to impose stricter liability on directors for breach of their common law duties or where their actions in implementing a merger have caused the company to suffer financial harm. As a result, this may deter directors from maximising returns to shareholders by engaging in competitive and responsible risk-taking whilst effectively managing the company concerned.<sup>394</sup> However, in contrast to this spirit of enterprise, directors should be held accountable for their decisions and actions. In light of this, the Act seeks to create a balance between these two competing values, namely: authority and accountability.<sup>395</sup>

The 2008 Companies Act introduces a new US-style BJR with the effect of alleviating the new less subjective and more rigorous duty of directors to exercise reasonable care, skill and diligence in the performance of their duties.<sup>396</sup>

Under the previous company law regime, the common-law standard of care imposed by the courts in South African law was considered to be patently inadequate in modern times to protect the shareholders from the carelessness and the negligence of the directors. This was evident as the law was benevolent towards directors on the

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<sup>391</sup> Muswaka L 'Directors' Duties and the Business Judgment Rule in South African Company Law: An Analysis' (2013) 3 *International Journal of Humanities and Social Science* 90.

<sup>392</sup> *Levin v Feld and Tweeds Ltd* 1951 (2) SA 401 (A) 402C-D.

<sup>393</sup> Lee (2005) 51.

<sup>394</sup> Lee (2005) 51.

<sup>395</sup> Lee (2005) 52.

<sup>396</sup> Cassim *et al* (2012) 563.

grounds that they were measured subjectively.<sup>397</sup> Therefore, a movement from a subjective to an objective approach was required. This development was introduced in section 76(3)(c) of the 2008 Companies Act.

The Act tightens up and advances the director's duty of care and skill by imposing a less subjective test and a slightly more demanding standard of care on directors than the common law. The legislator saw fit in imposing a mandatory duty which is owed to the company.<sup>398</sup> This development of the duty of care and skill is inherent in section 76(3)(c) of the Companies Act that establishes a two-fold dual standard that is partly objective and partly subjective.<sup>399</sup> The court's finding in the case of *Fisheries Development* noticeably depicts a two-fold dual standard where Morgan J established that there was a contrast between the directors' heavy duties of loyalty, as well as good faith, along with their light obligations of skill and diligence. However, Morgan J also held that a director may not be indifferent or a mere dummy. Furthermore, the director may not shelter behind culpable ignorance or failure to understand the company's affairs.<sup>400</sup> Consequently, in determining on whether a director is liable for neglecting his duty of care, skill, as well as diligence, the court will apply section 76(3)(c)(i) and (ii) of the Companies Act. Section 76(3)(c) of the Act provides the following:

(3) *"a director of a company, when acting in that capacity, must exercise the powers and perform the functions of director-*

*(c) with the degree of care, skill and diligence that may reasonably be expected of a person –*  
*(i) carrying out the same functions in relation to the company as those carried out by that director; and*

*(ii) having the general knowledge, skill and experience of that director."*

Directors are thus required to exercise the degree of care, skill and diligence that may reasonably be expected of a person carrying out the same functions as the director.<sup>401</sup> This standard is that of a reasonable person and not that of a reasonable director.

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<sup>397</sup> Cassim *et al* (2012) 558; Bouwman N 'An appraisal of the Modification of the Director's Duty of Care and Skill' (2009) 21 SA MLJ 511.

<sup>398</sup> Cassim *et al* (2012) 558.

<sup>399</sup> Cassim *et al* (2012) 559.

<sup>400</sup> *Fisheries Development Corporation of SA Ltd v Jorgensen, Fisheries Development Corporation of SA v AWJ Investments (Pty) Ltd* 1980 4 SA 156 (W) 166.

<sup>401</sup> Companies Act 71 of 2008, s 76(3)(c)(i).



Furthermore, in determining whether the particular director is liable for neglecting his or her duty of care, skill and diligence, the Act requires that the knowledge, skill and experience of the director in question to also be taken into account.<sup>402</sup> Therefore, if the director has any special skill or is more experienced or knowledgeable, his conduct will be measured against this higher subjective standard. Conversely, the more inexperienced the director is, the less level of care and skill is expected of that particular director, provided that he exercises reasonable care and skill.<sup>403</sup>

A director stands in a fiduciary relationship with his company with the result that he has a duty to act in good faith towards the company. Therefore, he must exercise his powers as director for the benefit of the company and avoid a conflict between his own interests and those of the company.<sup>404</sup>

Although the BJR has influenced South African corporate law jurisprudence since the 1950's, the 2008 Companies Act now provides for the rule in section 76(4) which may be utilised to protect honest directors from liability where a decision turns out to have been an unsound one.

The 2008 Companies Act provides protection to directors provided that the requirements mentioned in section 76(4)(a) are satisfied. Therefore, for a director to escape from liability, the decision must have firstly been an informed one. Secondly, the director must have no '*personal financial interest*' in the transaction in question. Therefore, the director must not be self-dealing. Lastly, the director must have had a rational basis for believing, and did believe that the decision was in the best interests of the company.<sup>405</sup>

If the requirements of section 76(4)(a) of the Act are satisfied, the director in question will not be liable for honest and reasonable mistakes or honest errors of judgement that the director may have made in managing the business of the company.<sup>406</sup> The director will thus be deemed to have complied with his duty to act in the best interests of the company and the duty of reasonable care, skill and diligence.<sup>407</sup> Furthermore,

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<sup>402</sup> Companies Act 71 of 2008, s 76(3)(c)(ii).

<sup>403</sup> Cassim *et al* (2012) 559.

<sup>404</sup> Botha (2009) 707.

<sup>405</sup> Companies Act 71 of 2008, s 76(4)(a).

<sup>406</sup> Cassim *et al* (2012) 565.

<sup>407</sup> Cassim *et al* (2012) 565.

on compliance with the three requirements stipulated in section 76(4)(a) of the Act, the merits and the wisdom of business decisions will fall outside the scope of judicial review.<sup>408</sup>

The BJR is considered to be controversial, but at the same, advantageous to the South African corporate law. The benefits of the statutory BJR provided for in the 2008 Companies Act can be summarised as follows. Firstly, the BJR provides for certainty and clarity to the laws relating to directors' duties. The reason for this is that it will provide a form of guidance to directors in making a business judgement in order to be protected against claims that they have breached their duty of care if their decisions turn out unfavourable, while simultaneously providing the courts with some assistance as to the standard required by directors as to when the rule might be invoked.<sup>409</sup>

Secondly, judges are not business experts and are often ill-equipped to evaluate directors' decisions in a corporate context.<sup>410</sup> The statutory BJR places courts in a better position to apply existing legal principles within a framework of rules such as notions of conflict of interest, reasonableness and rationality.<sup>411</sup>

Finally, should a stringent standard be placed on the directors in carrying out their functions and duties, there exists the possibility that competent directors will be too cautious in their business decisions which may stifle innovation and growth.<sup>412</sup> Therefore, the BJR not only strikes a balance between the company's and the director's interest, but it also encourages responsible risk-taking by providing directors with the comfort of knowing that their decisions will not be second-guessed by the courts if the requirements are met.<sup>413</sup> This in turn will stimulate South African company's economic growth and welfare.<sup>414</sup>

Although the statutory BJR offers many benefits to the South African company law, it is clear that it is not free from disadvantages. Many legal experts contend that it was not necessary for the legislatures to import the BJR into the South African company

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<sup>408</sup> Cassim *et al* (2012) 565.

<sup>409</sup> Lee (2005) 77.

<sup>410</sup> Schoeman N 'How the Companies Act impacts on directors' (2013) 13 *Without Prejudice* 13.

<sup>411</sup> Lee (2005) 77.

<sup>412</sup> Lee (2005) 77.

<sup>413</sup> Lee (2005) 77.

<sup>414</sup> Cassim M 'When companies are harmed by their own directors: The defects in the statutory derivative action and the cures (part 2)' (2013) 25 *SA Merc LJ* 310.

law for the following reasons. Firstly, it is contended that the degree of care and skill, which is found within the Companies Act, is disappointingly low as a result of the subjective standard.<sup>415</sup> This is clear, as a director who has a low standard of knowledge and experience in a particular business would easily be able to escape liability due to his incompetence. Therefore, the introduction of the statutory BJR makes the director's duties even more lax permitting directors to hide behind the statutory shield offered by the 2008 Companies Act should their business decision turn out to be disastrous. Furthermore, it is clear that the BJR was created to persuade competent persons to undertake directorship and to encourage risk-taking activities by directors. However, it is contended that these particular needs are in fact satisfied by virtue of the low degree of care and skill that is expected from directors in exercising their duties.<sup>416</sup>

In addition to the above, it is argued that it was undesirable for the South African legislature to adopt an American legal rule directly into the Companies Act due to the risks and uncertainty attached to it. This is founded upon the fact that America in two instances attempted unsuccessfully to codify the rule. In light of this, it is clear that relocating the rule directly from the American legislature into the South African company law may have unforeseen consequences which may be negative in nature.<sup>417</sup>

Finally, many academics strongly argue against the enactment of a statutory BJR for the reason that the courts have already applied an 'implied' or 'unwritten' BJR before the 2008 Companies Act was introduced into the South African company law, thus representing the courts unwillingness to review certain business decisions made by directors.<sup>418</sup> In fact, there has only been one decided case in which directors of a company were held liable for breach of the duty of care and skill. Up until now, directors have not been inundated with legal action for failing to act with due care and skill.<sup>419</sup> For this reason, many academics contend that it was unnecessary for the legislature to introduce the rule into the South African company law.

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<sup>415</sup> Kennedy-Good S 'The Business Judgement Rule (Part 2)' 2006 *Obiter* 280.

<sup>416</sup> Kennedy-Good (2006) 280.

<sup>417</sup> Kennedy-Good (2006) 291.

<sup>418</sup> Lee (2005) 79.

<sup>419</sup> Lee (2005) 72.

### **3.4) CONCLUDING REMARKS RELATING TO THE PROTECTION MECHANISM AND REMEDY**

The 2008 Companies Act was introduced to promote and facilitate commercial enterprise, as well as economic growth. At the same time, it was introduced to provide wider protection to various stakeholders, including the shareholders and directors. With the introduction of the appraisal rights and the statutory BJR, the Act achieves the abovementioned objectives by striking a balance between the interests of the companies on the one hand, and both minority shareholders and honest directors on the other.



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## **CHAPTER 4 – CONCLUSION AND RECOMMENDATIONS**

### **4.1. INTRODUCTION**

The importance of this dissertation derives from Robert Davis's view on the 2008 Companies Act, especially the reforms leading to the introduction of the statutory merger mechanism. In view of this, the goal of this research is to investigate whether the newly introduced statutory merger, as a fundamental transaction, is competent of being utilised in the South African context in order to provide for equitable and efficient mergers, amalgamations and takeovers of companies as stated in the preamble of the 2008 Companies Act.<sup>420</sup>

Upon introducing a new statutory legal concept, it is common that some degree of uncertainty will exist as to how it will be interpreted and applied by the courts. For the purpose of clarifying all uncertainty regarding the newly introduced statutory merger mechanism, this dissertation critically analysed some of the inconsistencies identified in the Act and the benefits that arise from the concept.

### **4.2. DISCUSSION ON FINDINGS OF THE DISSERTATION**

#### **4.2.1. Chapter 2 - The merger procedure**

Chapter 2 of this dissertation critically examined the newly introduced concept called the '*fundamental transaction*' established within the ambit of Chapter 5 Part A of the 2008 Companies Act. Furthermore, and most importantly, this chapter focused on the newly introduced '*amalgamation or merger*' transaction made available in section 113 of the new Companies Act.

Initially, the South African company law did not provide any rules that regulated the combining of the constituent companies into one. Instead, companies were required to utilise a merger similar to the current merger mechanism, but limited to an approval from the court and the acquisition of shares by way of schemes of arrangement or through the sale of business as a going concern.<sup>421</sup> The 1973 Companies Act thus proved to be out-dated and unreliable against the international trends. As a result of the exigency for simplified, flexible and comprehensive laws governing takeovers and

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<sup>420</sup> Companies Act 71 of 2008, preamble.

<sup>421</sup> Boardman (2010) 306 and 307.

mergers, the legislator promulgated the 2008 Companies Act. The new Companies Act overhauled the previous company law regime and modernised the South African company law framework by introducing a regulatory regime for fundamental transactions with the aim of facilitating the creation of business combinations. This newly introduced concept of fundamental transactions is often referred to as a generic term provided to all business transactions deriving from chapter 5 Part A of the 2008 Companies Act.<sup>422</sup>

One of the monumental introductions occasioned by the 2008 Companies Act is the newly introduced statutory merger transaction, which Cassim *et al* describe to be one of the leading reforms of the 2008 Companies Act. This groundbreaking concept introduced by the new Companies Act represents a substantial liberalisation of policy on the part of the legislature by addressing the conflicting values of facilitating the restructuring of businesses in the interests of economic growth.<sup>423</sup>

The statutory merger is considered to represent the pooling of assets and liabilities of two or more companies into a single company, which may be achieved either by combining companies or through a newly formed company.<sup>424</sup> The procedure for implementing a statutory merger is described to be a simple, uncomplicated and effective framework by which two or more companies may merge by agreement, with the approval of the prescribed majority of their shareholders, and without the general need for a court to approve the merger.<sup>425</sup>

Not only does the 2008 Companies Act provide a merger procedure that is simple and effective, it also provides various forms of merger structures that accommodate the companies' circumstances and needs. This introduction provides substantial latitude so as to permit an assortment of merger structures, each with its own uses and advantages.<sup>426</sup>

The merger procedure has been praised by many academic writers for representing a significant departure from the old regime and for aligning the South African company

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<sup>422</sup> Cassim *et al* (2012), 674 and 675.

<sup>423</sup> Cassim *et al* (2012) 674 and 677.

<sup>424</sup> Cassim *et al* (2012) 676.

<sup>425</sup> Cassim M (2008) 40.

<sup>426</sup> Cassim *et al* (2012) 702.

law with a number of major jurisdictions worldwide, including the US, Canada, France and Germany.<sup>427</sup>

In spite of the legislator's best intentions and attempts in enhancing the South African company law by introducing the much-needed statutory merger, there has been a reasonable amount of convincing criticisms in contradiction of the interpretation of the newly introduced concept and the implementation thereof. It is also evident through observing opinions of leading scholars who have attached a great deal of significance on the newly introduced merger concept that a consensus cannot be reached on the complications which the statutory merger transaction poses.

In light of the above, Chapter 2 of this dissertation focused on sections 113 and 116 of the 2008 Companies Act which set out the procedures for the merger transaction. Where the constituent companies propose to merge, they are required to enter into a written agreement setting out the terms and means of effecting the merger.<sup>428</sup> The statutory merger transaction thus gives companies considerable latitude to arrange the merger transaction in a manner that best meets their needs or requirements, thus accommodating the parties desired commercial objectives.

Upon implementation of the abovementioned merger agreement, boards of directors of the constituent companies are required to consider the solvency and liquidity test.<sup>429</sup> Although deemed to be a key safeguard for creditors of the merging companies, the test is not clear from censures and uncertainty. As opposed to the old company law regime, the 2008 Companies Act introduced the 12-month requirement in the liquidity element to protect the creditors by providing directors more certainty when applying the test.<sup>430</sup> In contrast, the 12-month period has been criticised for being disadvantageous towards creditors who may have foreseeable longer-term commitments that are not payable within twelve months and that the operations of each company should instead be the decisive factor in judging its liquidity.<sup>431</sup>

The above criticisms are unconvincing as the 12-month time limit eliminates uncertainty when directors apply the solvency and liquidity test, thus providing for

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<sup>427</sup> Davids *et al* (2010) 341; Cassim *et al* (2012) 677.

<sup>428</sup> Companies Act 71 of 2008, s 113(2).

<sup>429</sup> Companies Act 71 of 2008, s 113(4).

<sup>430</sup> Stein (2011) 176.

<sup>431</sup> Van der Linde (2009) 229.

effective implementation of a merger transaction. In addition, the 12-months' timeframe does not only provide a set timeframe for all companies to comply with the liquidity element, regardless of its size and operations, but it too provides the board with assistance in making a cash flow prediction when determining whether the company will satisfy the test. In light of this, the time limitation in the solvency and liquidity test is appropriate to ensure certainty in determining the company's state of financial health.

A company satisfies the solvency and liquidity test if the assets of the company, at both company and group level, exceed its liabilities. Furthermore, the company must also be able to pay its debts as they become due in the ordinary course of business.<sup>432</sup>

It appears from section 4(1)(a) of the 2008 Companies Act that the solvency and liquidity test is required to be revised as it is clear that the test are considered at both company and group level. The distinction that emerges from the provision however makes no difference and thus appears to be anomalous. Therefore, where a subsidiary is concerned, references should be made to the assets and liabilities of the 'consolidated group' and not 'company'. Furthermore, it is clear from the provision that should a subsidiary intend to merge with another company, the entire group would have to be subject to the solvency and liquidity test, including the holding company. This is considered to be impractical and the required assessment of the group would be ideal if the wording was amended to '*if the company is a holding company*' instead of '*if the company is a member of a group*'.<sup>433</sup>

In addition to the above, it is clear that the solvency element applies to both the company and the company that is a member of a group. In contrast, the liquidity element strangely only makes reference to the company and not the group of companies. This requires an amendment as it is illogical for the liquidity consideration to be limited to the company and not extended to the group of companies.<sup>434</sup> Although problematic, the test can be rectified through better formulation and meticulous cross-referencing.<sup>435</sup>

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<sup>432</sup> Companies Act 71 of 2008, s 4(1).

<sup>433</sup> Wainer HE (2009) 807.

<sup>434</sup> Wainer HE (2009) 807.

<sup>435</sup> Van der Linde (2009) 240.



Once it is determined by the board of directors that the companies involved in the merger have satisfied the solvency and liquidity test, a special resolution must be passed by a quorum of shareholders from each company representing at least 25 per cent of the voting rights exercisable in respect of the merger.<sup>436</sup> Although this would typically mean that the support of at least 75 per cent of the shareholders present at the meeting would need to approve the merger, the new Companies Act permits the threshold to be reduced to as low as 60 per cent.<sup>437</sup>

While the shareholder approval requirement has been inserted to protect minority shareholders, as well as to strike a balance between this protection and the wishes of the overwhelming majority of shareholders, reservations exist as to whether a company may validly alter the percentage of voting rights to approve a special resolution to merge.<sup>438</sup>

Although section 65 provides for such alteration, section 115 of the Act unequivocally applies to a merger and seemingly prohibits a company from relying on section 65 to alter the requisite 75 per cent support for a merger to be approved. Therefore, on strict interpretation, the 75 per cent threshold is fixed and may not be altered. In spite of this, shareholders requiring protection may provide in the company's Memorandum of Incorporation for an increased quorum for the meeting.<sup>439</sup>

The Companies Act, as highlighted in section 115, also gives greater protection to dissenting shareholders by requiring the company to seek court approval for the proposed merger, or simply review the transaction if the court is satisfied that the dissenting shareholders are acting in good faith, it appears that the applicants are prepared to sustain the proceedings and the alleged facts prove that the resolution was manifestly unfair or the voting for such resolution was procedurally irregular. Such protection is however dependent on the requirement that the dissenting shareholders have applied to court within the specified time.<sup>440</sup>

Although the Companies Act offers protection when implementing a merger, it is unclear whether the same protection is afforded to the acquiring company in the case

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<sup>436</sup> Davids *et al* (2010) 347.

<sup>437</sup> Companies Act 71 of 2008, s 65(10).

<sup>438</sup> Stein (2011) 294.

<sup>439</sup> Companies Act 71 of 2008, s 115; Cassim *et al* (2012) 691.

<sup>440</sup> Companies Act 71 of 2008, s 115.

where it transpires that the business, assets or profits of the target company is affected by material adverse changes. For this reason, in order for companies to avoid acting against their own interest due to the unforeseen circumstances that may emerge during the implementation of a merger, it is clear that the legislator ought to insert a provision in the Companies Act allowing a MAC clause to be attached to merger agreements, consequently permitting the acquiring company to revoke the merger proposal on grounds of the MAC provision.

Since companies may effect a merger without the consent of its creditors, the Act requires that the constituent companies notify all of its creditors that have a contractual or delictual claim against the merging companies.

Due to the current economic climate, creditors may become apprehensive about their claims where the company enters into a merger. The Act offers protection to objecting creditors by permitting courts to review the merger transaction provided that an application is made within 15 days after receiving notice of the merger, the application is made in good faith, the creditor will be materially prejudiced by the merger, and that no other remedies exist to objecting creditors.

Once the merger transaction has satisfied all the requirements in section 115 of the Act, a notice of merger must be filed with the Companies Commission whereby the Commissioner will issue a certificate confirming registration of the newly incorporated company. Although the implementation appears to be simple, it is not clear on the position of intra-group mergers as the Act expressly prohibits holding companies from voting on a resolution, thus making it impossible for holding companies to satisfy all the requirements in section 115. To avoid such ambiguities, the solution lies in the maxim *lex non cogit ad impossibilia aut inutilia* which, if adopted in the Act, would eliminate this exclusion prohibiting the holding company from voting on the resolution, thus allowing transactions such as intra-group mergers to satisfy all the requirements in the Act.<sup>441</sup>

Once the requirements in section 115 of the Act have been satisfied, all of the assets and liabilities of the constituent companies would automatically vest, by operation of the law, in the surviving company. Not only does the Act provide a mechanism that

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<sup>441</sup> Latsky (2014) 377. This provides that the law does not operate for an impossible purpose.

effectively and simply transfer assets to the surviving company, it too saves the company a large amount of time and costs involved in concluding a merger.<sup>442</sup>

Although the Act expressly provides for automatic transfer of assets and liabilities, nothing is said of commercial contracts which prohibit the vesting of contractual rights in the surviving company, in other words, a *pactum de non cedendo*. For the reason that a *pactum* only prohibits a voluntary act of transfer, the common law rule consequently does not prohibit an automatic transfer of rights by operation of law. It is unclear as to why the legislator would subject the automatic assumption of assets and obligations to the requirements of 'any other agreement' in section 116(7) of the Act.

The legislator ought to remove any doubts, as upon closer inspection of the provision, the Act fails to expressly provide that the company would by operation of the law step into the shoes of the merging company. This is not only abstruse, but it may also be prejudicial to creditors of the disappearing company by going beyond the true intention of a merger under the 2008 Companies Act, which is to consolidate assets and liabilities in a manner that is simple, and which saves time and costs.

Despite the benefits of the statutory merger procedure, from the research conducted in Chapter 2, it appears that there are many issues which will arise when implementing a merger. As a result, to clarify all the ambiguities surrounding the implementation of a merger transaction, certain amendments to various clauses giving effect to the merger procedure would be necessary.

#### **4.2.2. Chapter 3 - Appraisal rights and the BJR**

Since a merger has considerable consequences for shareholders of the constituent companies, the 2008 Companies provides an exit mechanism to dissenting shareholders who disapprove of a resolution to merge. Inspired by the American corporate law, the appraisal right provides dissenting shareholders with the right to have their shares bought out by the company at a price reflecting the fair value of the shares.

The appraisal right is only afforded to disgruntled shareholders who have complied with all the requirements in section 164 of the Companies Act. It is submitted that the

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<sup>442</sup> Companies Act 71 of 2008, s 116(7).

procedure is somewhat prejudicial to dissenting shareholders as it requires strict compliance and meticulous attention, involving requirements that must be satisfied within a specified time limit. This is disadvantageous to dissenting shareholders who have failed to comply with the procedure timeously, thus requiring them to remain in the company despite their disapproval of the merger. To ensure that the protection provided by the Companies Act operates in favour of the company and the dissenting shareholders, and to guarantee shareholder compliance with the procedural requirements established in the Act, it is suggested that the courts should be given discretionary powers to extend the prescribed time limits to comply with the procedure described in section 164 of the Act; or interpret the provision as flexible and lenient as possible with the aim of excusing the lack of strict compliance by a shareholder who is genuinely seeking an egress despite its attempt to comply with the procedure.<sup>443</sup>

By introducing the appraisal right, the Companies Act provides companies with ease in making major decisions without interruption from the minority shareholders who disapprove of the merger. In contrast to the legislature's best intentions in providing dissenting shareholders with appraisal rights, the effectiveness of the remedy is rather reduced by neglect and its procedural flaws. Since the 2008 Companies Act came to effect, no appraisal rights have been brought before the courts nor has anybody reported using the remedy in the media. This begs the question whether the remedy is a pointless addition to the Companies Act. Unless the South African economy creates a circumstance where dissenting shareholders exercise their appraisal right, it remains to be seen whether the remedy will remain ineffective and become redundant.

In addition to the protection afforded to shareholders, the Companies Act have also extended its protection to directors by codifying the Business Judgement Rule into South African law. This American rule serves to prevent courts from interfering and holding directors accountable for decisions which inadvertently went against the companies' best interests.

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<sup>443</sup> Cassim (2008) 20 SA Merc LJ at 165; Wertheimer B (1998) at 709.

In light of the Fidentia scandal and the trends around the world where directors were found to be liable for commercial decisions that fell foul to bad luck, the legislators have imposed a less subjective and more demanding duty on directors to perform their tasks with reasonable care, skill and diligence. Although necessary to protect companies from poor decision making by its directors, this may hinder innovation and growth. To alleviate this dual standard that is placed on directors, the Companies Act provides immunity from liability provided that the decision was an informed one, no self-dealing was involved in making a decision affecting the company, and the director believed that the decision was in the best interests of the company.<sup>444</sup>

Although the South African legislature took a risk in introducing the statutory BJR into the South African company law, it is clear that it is highly beneficial to both the companies and the directors. It does not only protect honest directors from making risky business decisions which may result in either a rewarding or a disastrous outcome, but it also promotes growth within the company and the economy. It is clear that the benefits of this foreign mechanism outweigh the disadvantages and the controversies surrounding the rule. Furthermore, the BJR plays an imperative role in usurping the courts function when deciding on a business matter as courts lack the commercial or business acumen in deciding on corporate decisions. However, the BJR is required to be utilised with caution as it is still unclear what negative consequences it may have in the South African context.

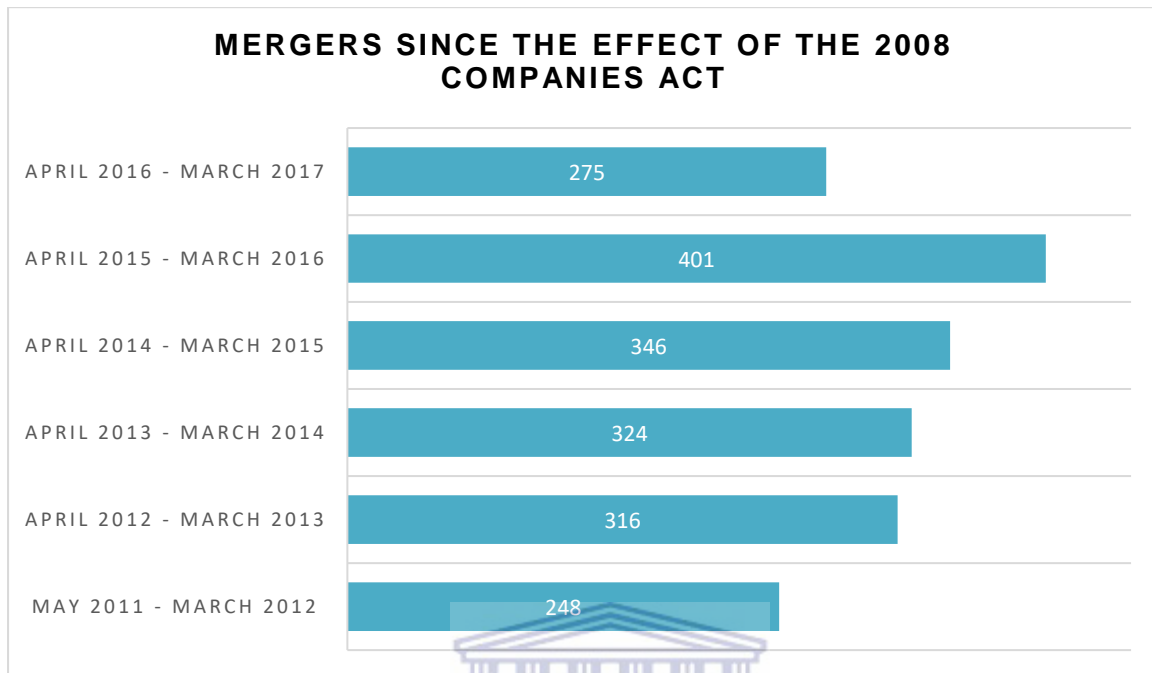
#### **4.3. RECOMMENDATION AND CONCLUSION**

The introduction of the statutory merger is a major reform to South African company law. Not only has the 2008 Companies Act inserted a number of features to the merger mechanism that benefits and protects companies, shareholders, directors and creditors; the newly introduced concept will certainly improve the environment for business operation in South Africa. The statutory merger procedure provided under the new Act is deemed to be a huge step-up to the previous company law as it undoubtedly facilitates the creation of business combinations, promotes flexibility and enhances efficiency in the South African economy. This can be seen in the below chart

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<sup>444</sup> Cassim *et al* (2012) 565.

of the mergers that have been concluded since the implementation of the 2008 Companies Act.<sup>445</sup>



Although the newly introduced merger procedure is welcomed in South Africa corporate law based on the practical advantages arising from the mechanism, the present research has identified various anomalies in the Act that the legislators can investigate and implement in order to optimise the effectiveness and understanding of the procedure. As set out in chapter 2 and 3 of this thesis, it is respectfully submitted that the legislature should analyse the current merger procedure in section 113, as well as the appraisal right and BJR in section 164 and section 76(4)(a) respectively, with a view to:

- i) Clarifying inconsistencies and errors arising in the solvency and liquidity test;
- ii) Clarifying issues surrounding the implementation of statutory mergers in wholly-owned group companies;
- iii) Shedding light on the uncertainties arising from an approval of mergers, with specific reference to section 65 of the Act;

<sup>445</sup> 'Merger and Acquisition Activity Update' available at <http://www.compcom.co.za/merger-and-acquisition-activity-update/> (accessed on 06 August 2017).

- iv) Clarifying concerns relating to the transfer of commercial contracts, upon implementation of the merger, and which has a non-assignment clause attached to it;
- v) Considering the Material Adverse Change clause to terminate the merger agreement in situations where it appears that the target company is effected by material adverse changes;
- vi) Clarifying the uncertainty in determining the fair value of the shares when a shareholder exercises his or her appraisal right.



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