THE LIMITATION OF THE APPRAISAL RIGHT REMEDY THROUGH THE NEUTRALISATION OF THE RIGHT

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Abstract

This research critically examines the different methods that can be used in corporate practice to limit the occurrence and neutralise the enforcement of the appraisal rights remedy in both South Africa and the state of Delaware. The research initially conducts a comparative analysis of the appraisal rights remedy provided in section 164 of the Companies Act 71 of 2008 against the appraisal rights remedy provided in the Model Business Corporation Act and the Delaware General Corporation Law in the United States of America. Thereafter a critical analysis of the concerns of companies in the context of transactions that trigger appraisal rights and the methodologies that can be utilised by companies in both South Africa and the United States, particularly in the state of Delaware, is undertaken. The research then considers the role that shareholder activism has played in counteracting these methods in the United States and how shareholder activism in South Africa is encouraging the utilisation of the appraisal rights remedy. It is submitted that the appraisal rights remedy can be used as a tool of shareholder activism as appraisal rights have a governance aspect inherent in them. It is argued that the development of appraisal arbitrage and appraisal bumpitrage, which is the practice of exercising or threatening to exercise appraisal rights by shareholders, that has arisen in the United States, is beneficial to good corporate governance in the context of appraisal rights triggering transactions. It is further submitted that it is only a matter of time before appraisal right litigation becomes a common feature in the South African legal system as shareholder activism grows. The research also suggests and recommends that certain amendments could be made to the provisions of section 164 in order to assist shareholder activists and minority shareholders alike to exercise and enforcement of their appraisal rights and to fast tracking the process.

Key terms:

Section 164; Companies Act 2008; appraisal remedy; shareholder activism;

Appraisal arbitrage.

TABLE OF CONTENTS

Contents

TABLE OF CONTENTS 4

CHAPTER 1: INTRODUCTION 6

1.1. Introduction to the study 6

1.2. The problem statement 7

1.3. Research questions and issue that are examined 8

1.4. Purpose and objective of the study 8

1.5. Scope and methodology of the study 9

1.6. Literature review 9

1.7. Outline of the chapters of the research 10

CHAPTER 2: THE APPRAISAL RIGHTS REMEDY IN SOUTH AFRICA AND ITS NEUTRALISATION THROUGH ANTI-APPRAISAL MECHANISMS 12

2.1. Introduction and background to appraisal rights 12

2.2. The purpose of the appraisal rights remedy set out in section 164 of the Companies Act 13

2.3. Instances when the appraisal rights remedy arises 15

2.4. Procedure for enforcement of the appraisal rights remedy 18

2.5. Anti-appraisal mechanisms in South Africa 22

2.5.1. Utilisation of mechanisms that do not trigger appraisal rights 23

2.5.2. Entering into support agreements with shareholders 25

2.5.3. Appraisal Right Conditions Precedent 29

2.5.4. Revocation Resolutions 32

2.6. Conclusion 33

CHAPTER 3: APPRAISAL RIGHTS AND ANTI-APPRAISAL MECHANISMS IN THE UNITED STATES 35

3.1. Introduction and background 35

3.2. Legal Framework in the United States 36

3.3. Trigger events under the Model Business Corporations Act and the Delaware General Corporation Law 36

3.4. Appraisal rights procedure in terms of the Model Business Corporations Act and the Delaware General Corporation Law 41

3.5. Determination of 'fair value' in the Delaware jurisdiction 45

3.6. Anti-appraisal mechanisms in the United States 52

3.6.1. Utilisation of company law mechanisms that do not trigger appraisal rights 53

3.6.2. Entering into support agreements with shareholders ... 54
3.6.3. Appraisal rights conditions precedent ... 56
3.7. Conclusion ... 57
CHAPTER 4: THE DEVELOPMENT OF APPRAISAL ARBITRAGE RIGHTS IN THE UNITED STATES ... 59
4.1. Introduction ... 59
4.2. Shareholder activism and appraisal arbitrage in the United States ... 61
4.2.1. Carl Icahn in the Dell transaction ... 62
4.2.2. Dole Food Company versus dissenting shareholders ... 62
4.2.3. Starz Inc. and Lions Gate versus dissenting shareholders ... 63
4.2.4. Paul Singer – an example of a bumpitrager ... 64
4.3. Appraisal rights as an unconventional tool for shareholder activism ... 65
4.4. Appraisal Arbitrage as a form of shareholder activism ... 67
4.5. Conclusion ... 70
CHAPTER 5: THE DEVELOPMENT OF SHAREHOLDER ACTIVISM IN SOUTH AFRICA ... 72
5.1. Introduction ... 72
5.2. Instances where the appraisal rights remedy has been exercised or threatened by shareholder activists in South Africa ... 74
5.2.1. KWV Holdings Limited's disposal of majority of assets ... 74
5.2.2. Gooderson Leisure Group delisting ... 75
5.2.3. The PPC and AfriSam proposed merger ... 76
5.2.4. Sovereign Food Investments Limited (Sovereign) vs Country Bird Holdings Limited (CBH) vs Other Shareholder Activists ... 77
5.3. Conclusion ... 79
CHAPTER 6: CONCLUSION ... 80
6.1. Introduction ... 80
6.2. Discussion on findings of the research ... 81
6.3. Recommendations and conclusion ... 84
BIBLIOGRAPHY ... 85

CHAPTER 1: INTRODUCTION

1.1. Introduction to the study

The Companies Act[1] provides shareholders with the appraisal right, set out in section 164 of the Companies Act, which is a right for a dissenting shareholder to demand payment from the company for the fair value of his / her shares. The appraisal right further empowers a dissenting shareholder to make an application to the courts to have the fair value determined. [2] The appraisal right remedy was included in the Companies Act as a minority shareholder protection that can be utilised in a limited number of instances which are when a company proposes to implement certain transactions. Notwithstanding that the remedy is limited to a small number of triggering events, based on an observation of corporate transaction practice in South Africa in the last five years; the number of triggering fundamental transactions has steadily increased.[3]

However, there is a paucity of appraisal right litigation in South Africa. To date, the courts have only until recently adjudicated over matters that are related to the rights of dissenting shareholders following the exercise of appraisal rights.[4] The courts have most recently adjudicated on a matter of the ambit and whether the right applied to dissenting shareholders of the holding company when a disposal of assets was undertaken by its subsidiary.[5] The paucity in appraisal litigation in South Africa is in contrast to the concerns of 'a potential abuse of the remedy' that were initially raised when the remedy was introduced into the South African legal system.[6]

The reason for the low number of appraisal right adjudication in South Africa cannot be attributed to a single cause and many factors that have been advanced which primarily include the stringent procedural requirements, high costs, time delays and uncertainty of the

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[1] Act 71 of 2008 (herein referred to as 'the Companies Act').
[2] Section 164(5) the Companies Act.
[3] Takeover Regulation Panel annual reports for the years ended 31 March 2012 to 31 March 2017 available at *http://trpanel.co.za/financials/* accessed on 28 July 2017.
[4] *Juspoint Nominees (Pty) Ltd and Others v Sovereign Food Investment Limited and Others (BNS Nominees intervening)* ECP (unreported case no 878/16, 2016). *Loest v Gendac (Pty) Limited and Another* 2017 (4) SA 187 (GP).
[5] *Cilliers v LA Concorde Holdings Limited and Others* (23029/2016) [2018] ZAWCHC 68.
[6] MF Cassim 'The introduction of the statutory merger in South African corporate law: majority rule offset by the appraisal right 2008 Part 2' *South African Mercantile Law Journal* 147. HGJ Beukes 'An introduction to the appraisal remedy in the Companies Act 2008: standing and the appraisal procedure' (2010) 22 *South African Mercantile Law Journal* 1, 176. HGJ Beukes 'An introduction to the appraisal remedy as proposed in the companies bill: Triggering actions and the differences between the appraisal remedy and the existing shareholder remedy' (2008) 20 *South African Mercantile Law Journal* 479.

determination of fair value by the courts under the remedy.[7] These factors have been examined at length by a number of researchers and will not be considered further in this dissertation.

From the perspective of a company, the enforcement of appraisal rights by several dissenting shareholders can have the effect of minority shareholders frustrating the implementation of corporate activities, increasing the funding required for the transaction and embroil the company in lengthy and costly litigation. Appraisal rights have become an important factor that a company considers in the planning, negotiation and consummation of corporate transactions.[8] As such, companies, seek to find a way to avoid or to manage the risk that appraisal rights could pose.

1.2. The problem statement

Another reason that can be ascribed for the paucity of appraisal right litigation is the use of transaction structuring and contractual mechanisms (anti-appraisal mechanisms) that have the effect of reducing the occurrence and exercise of the appraisal remedy.

These anti-appraisal mechanisms include:

a) Avoiding triggering the appraisal rights remedy by utilising other takeover mechanisms that do not fall under fundamental transactions in the Companies Act.
b) Entering into vote and support agreements with major shareholders of the company, so as to ensure that sufficient shareholder support for the transaction is obtained.
c) Utilising a condition precedent in the transaction agreement that provides that should a certain number of dissenting shareholders exercise their appraisal rights, the acquiring party and/or the company has a right to terminate the proposed transaction.
d) Revoking the proposed transaction should a certain number of dissenting shareholders exercise their appraisal rights.

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[7] Jacqueline Yeats *The Proper and Effective Exercise of Appraisal Rights Under the South African Companies Act, 2008: Developing a Strategic Approach through a Study of Comparable Foreign Law* (unpublished Doctoral Thesis, University of Cape Town, 2015) 157-58. Mary Siegel 'Back to the future: appraisal rights in the twenty-first century' (1995) 32 *Harvard Law Journal* 79. Mary Siegel 'An appraisal of the Model Business Corporation Act's appraisal rights provisions (2011) 74 *Law and Contemporary Problems* 231. Bayless Manning 'The shareholders appraisal remedy, an essay for Frank Coker' (1962) 72 *Yale Law Journal* 613.

[8] D Katz 'Shareholder activism in the M&A context' (2014) *Havard Law Journal* available at http://blogs.law.harvard.edu/corpgov/2014/03/27/shareholder-activism-in-thema-context accessed on 24 March 2017. See also JJ Garza Castañeda 'Appraisal rights: The "fair" valuation of shares in case of dissent' 1999 September – December *The University of Mexico Law Journal* 809 at 814.

However, these anti-appraisal rights do not operate in a vacuum and are being applied in an era of increasing shareholder activism where shareholder activists can counter-act the effects of anti-appraisal mechanisms.

The focus of this dissertation is on the limitation of the appraisal rights remedy through corporate practices of anti-appraisal mechanisms and the ability of these mechanisms to reduce the occurrence and exercise of the appraisal remedy in the age of shareholder activism.

1.3. Research questions and issue that are examined

This dissertation will consider the effect of these limitation mechanisms on the occurrence and exercise of appraisal rights and will also discuss how these limitation mechanisms can be made ineffective as a result of shareholder activism.

This research evaluates several aspects of appraisal rights and in answering the main question, the following questions are considered:

a) What anti-appraisal mechanisms do companies utilise to neutralise dissenting shareholders and to what extent can these measures limit the occurrence of and the exercise of the appraisal right remedy?

b) How have these measures been applied in the United States and how has shareholder activism curbed the neutralisation of the appraisal right remedy?

c) How can shareholder activism in the context of appraisal rights be used as a tool to counteract the neutralisation of appraisal rights in South Africa?

1.4. Purpose and objective of the study

The objective of the research is to analyse how and evaluate to what extent these anti-appraisal mechanisms limit the occurrence and enforcement of appraisal rights within the context of the South African legal system. In the process of this analysis an attempt will be made to illustrate that such anti-appraisal mechanisms are against the purpose for which appraisal rights were legislated. The research will also endeavour to argue that the emergence of shareholder activists has reduced the ability of some of the anti-appraisal mechanisms to limit the appraisal rights remedy in some instances. The research will further make suggestions certain amendments to the Companies Act to restrict certain anti-appraisal mechanisms and to further empower minority shareholders.

1.5. Scope and methodology of the study

The study is desk-bound research and is limited to information extracted from local and international sources which include, inter alia, case law, legislation, academic books, journal articles, as well as communication and documents provided to shareholders (i.e. circulars and company announcements on stock exchange news platforms) media reports and news articles. The appraisal right remedy is fairly new in South African law and, unfortunately, there is limited case law and literature on the subject.

The research methodology that will be utilised includes a critical analysis of the purpose and policy considerations of appraisal rights set out in the Companies Act. The research will also critically analyse and evaluate each of the anti-appraisal mechanisms that are utilised to neutralise the occurrence and exercise of appraisal rights in South Africa.

As the appraisal right remedy was adopted from the United States of America (United States) and the limitation mechanisms were also replicated from the United States, the research will conduct a comparative analysis of the appraisal right remedy in the United States and consider the application and effect of these limiting mechanisms in the United States, in particular the state of Delaware. The research will also consider how the relationship between appraisal rights and appraisal arbitrage has evolved in the United States to counteract the need for anti-appraisal mechanisms. The choice of using the Delaware jurisdiction for purposes of a comparative analysis is premised on the fact that the state of Delaware has developed considerable jurisprudence on the matter.

1.6. Literature review

Several writers on the subject of appraisal rights have focused on the implications of the introduction of the remedy into the South African legal system.[9] These writings were mainly published prior to the Companies Act coming into force and there was still uncertainty in respect of appraisal rights' role in South Africa. Following the effective implementation of the appraisal rights remedy, other writers have written on certain aspects of the appraisal rights

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[9] FHI Cassim, (ed), MF Cassim, R Cassim, R Jooste; J Shev, and J Yeats *Contemporary Company Law* 2 ed (2012) 719-737. MF Cassim '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 19. MF Cassim 'Part 2' op cit note 6. HGJ Beukes (2008) op cit note 6. HGJ Beukes (2010) op cit note 6. See also K Cron 'Shareholder appraisal rights under the new Companies Act: Boon or bust?' available at *http://www.nortonrose.com/news/45534/shareholder-appraisal-rights-underthe-new-companies-act-boon-or-bust* accessed 16 January 2018.

remedy which focus on issues such as its role as a minority shareholder protection in fundamental transactions,[10] the methods that may utilised by the courts to determine fair value of shares,[11] the effective use of the appraisal remedy.[12] As a result of there being no jurisprudence on the interpretation and approach on the subject, majority of this literature approaches appraisal rights from a comparative perspective to discuss how these aspects of appraisal rights may be applied in a South African context.

Notwithstanding that there is now jurisprudence on certain aspects of the South African court's approach on the issue of appraisal rights, this jurisprudence is limited in respect of the focus of this dissertation. This has the implication that this study must also embark on a comparative analysis with the appraisal rights remedy landscape in other foreign jurisdictions, being the jurisprudence of the United States, particularly the state of Delaware, for purposes of a comparative analysis on the subject.

1.7. Outline of the chapters of the research

The research will follow the following structure:

Chapter 1, set out herein, generally introduces, narrows down the topic of the research, the objective of the research and the methodology to be utilised.

Chapter 2 sets out the position of appraisal rights and the anti-appraisal mechanisms utilised in South Africa. The chapter will provide a background to the South African legal system and discusses the purpose and policy considerations for the introduction of the appraisal rights remedy in the Companies Act. The chapter discusses the instances in which the appraisal rights remedy arise and sets out the procedure for the enforcement of the appraisal right remedy in South Africa. Thereafter the anti-appraisal mechanisms that can be utilised to limit the

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[10] Adetoun Adebanjo 'Appraising the appraisal remedy: Is it really the best option for dissenting shareholders?' available at *http://papers.iafor.org/wp-content/uploads/papers/ecpel2014/ECPEL2014_00530.pdf* accessed 9 October 2018. See also Peter John Evelyn *A comparison of minority shareholder rights under the takeover regulations in South Africa and the United States of America* Unpublished LLM dissertation, University of Johannesburg (2016) available at *https://ujcontent.uj.ac.za/vital/access/services/Download/uj:20912/SOURCE1* accessed 9 October 2018.

[11] Adekunle Rotimi Olaofe *Appraisal right and fair value determination under the Companies Act No 71 2008: A critical analysis* Unpublished LLM dissertation, University of Cape Town (2013). See also Kevin Ross Hillis *The appraisal remedy and the determination of fair value by the courts* Unpublished LLM dissertation, UNISA (2014).

[12] J Yeats op cit note 7, Jacqueline Yeats 'Putting appraisal rights into perspective' 2014 *Stellenbosch Law Review* 328.

appraisal rights remedy will be set out and the extent of their limitation on the appraisal rights remedy will be discussed.

Chapter 3 contains a comparative analysis of the appraisal rights in the United States which set out the appraisal rights provisions in the Model Business Corporation Act and the Delaware General Corporation Law. Such analysis will identify the differences and similarities of the statutory provisions in the United States compared to the landscape in South Africa. The chapter will also discuss in brief how the Delaware Court of Chancery and Delaware Supreme Court have determined the fair value of shares in several cases. The chapter further discusses the anti-appraisal mechanisms that are used to limit the appraisal right in the state of Delaware.

Chapter 4 discusses how appraisal rights and appraisal arbitrage has developed as a tool for shareholder activists in the United States and how a transparent and fair process and a high deal price is the best anti-appraisal method for companies to ensure that appraisal rights are not exercised

Chapter 5 will introduce shareholder activism in the context of fundamental transactions in South Africa and discuss the how there has been a significant rise of shareholder activism and how this may be beneficial for the appraisal rights landscape in South Africa.

Chapter 6 concludes that, although appraisal rights are capable of being limited by anti-appraisal mechanisms employed by companies, the right in itself cannot be completely neutralised in its entirety. It is concluded that shareholder activism mechanism at counter-acting the anti-appraisal mechanisms and the legislature, however, amendment to legislation could assist in ensuring that the anti-appraisal mechanisms have little to no effect in South Africa.

CHAPTER 2: THE APPRAISAL RIGHTS REMEDY IN SOUTH AFRICA AND ITS NEUTRALISATION THROUGH ANTI-APPRAISAL MECHANISMS

2.1. Introduction and background to appraisal rights

The introduction of s164 of the Companies Act represents one of the statutory innovations brought into South African company law by the legislature. The appraisal right remedy provides a dissenting shareholder who disagrees with the proposed fundamental transaction, with a right to compel the company to purchase its shares at fair value from the shareholder.[13] Prior to the introduction of appraisal rights, the only way a shareholder could obtain an order forcing the company to buy back its shares was under s252 of the Companies Act of 1973.[14]

The remedy was introduced as part of the legislature's efforts to modernise the South African company law when the Companies Act of 1973[15] in 2011. The uniqueness of the appraisal right remedy is premised on how the remedy provides a shareholder with a means to exit the company.[16] It essentially functions as a put option that a dissenting shareholder can exercise against a company which if triggered allows the shareholder to demand that the company buy his/her shares at a fair value.

[13] Section 164 of the Companies Act. HGJ Beukes (2008) op cit note 6 at 479.

[14] Section 252(3) of the 1973 Act provided shareholders with a remedy against conduct that is unfairly prejudicial, unjust or inequitable to a shareholder and an aggrieved shareholder could apply to court to have the conduct of the directors or the company be declared unfairly prejudicial, unjust or inequitable. Upon making this declaration, if the court deemed it just and equitable, the court could, with the intention of bringing an end to the matters complained of, make such order it deems fit, which included regulating the affairs of the company or making an order for the shares of the aggrieved party to be purchased by the company or majority shareholders of the company in order for the aggrieved shareholder to exit the company. In *Garden Province Investment Others v Aleph (Pty) Ltd* 1979 (2) SA 525 (D) at 531 the court held that the aggrieved shareholder bore the burden of proof and '[a] minority shareholder seeking to invoke the provisions of s 252(1) of the Companies Act must establish not only that a particular act or omission of a company results in a state of affairs which is unfairly prejudicial, unjust or inequitable to him, but that the particular act or omission itself was one which was unfair or unjust or inequitable. Similarly, looking at the second part of the section, where the complaint relates to the manner of conduct of the business, it is the manner in which the affairs have been conducted as well as the result of the conduct of the business in that manner which must be shown to be unfairly prejudicial, unjust or inequitable.'

[15] Companies Act 61 of 1973 (herein referred to as the '1973 Act').

[16] MF Cassim 'Part 1' op cit note 9 at 19. See also E Davids, T Norwitz & D Yuill 'A microscopic analysis of the new merger and amalgamation provision in the Companies Act 71 of 2008' 2010 *Acta Juridica* 337 at 352.

2.2. The purpose of the appraisal rights remedy set out in section 164 of the Companies Act

The appraisal rights remedy is considered to be one of the prominent protections of minority shareholders in South African company law.[17] The legislature saw it fit to introduce the appraisal right in South Africa on the basis that:

> 'It is particularly important that effective remedies are in place for shareholders and investors to enable them to exercise their rights... Furthermore, exit and appraisal rights should be identified and given content, particularly to provide smaller investors the ability to make informed choices, where they are unable to influence company direction and decisions effectively or to pursue private actions against the company in civil courts.'[18]

Accordingly, the first purpose of the right was so as to empower dissenting shareholders with a simpler mechanism of divesting from a company that what had been previously provided for the 1973 Act. The appraisal right is in essence a deviation from the rule of the majority that was articulated in *Sammel v President Brand Gold Mining Co Ltd*[19] where it was stated that:

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

It must be noted that the appraisal remedy does not necessarily dilute or override the power of the majority shareholders but seeks to provide protection and fairness as held by Papier J, in the case of *Cilliers v La Concorde*.[20]

In addition to a dissenting shareholder having the power to demand payment of fair value, the remedy further empowers a dissenting shareholder with the ability to challenge the adequacy of the price offered for the purchase of those shares by the company by making provision for a dissenting shareholder to approach the court for purposes of determining the fair value of shares.

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[17] *Loest v Gendac* supra note 3 para 19.

[18] Department of Trade and Industry in South Africa *South African Company Law for the 21st Century Guidelines for Corporate Law Reform* General Notice 1183 of 2004, Government Gazette, 23 June 2004 at 39.

[19] *Sammel and Others v President Brand Gold Mining Company Ltd* 1969 (3) SA 629 (A) 678.

[20] *Cilliers v La Concorde* supra note 5 para 44.

Secondly, it can be argued that one of the reasons for the introduction of appraisal rights was so as to align South Africa's corporate law with that of international standards. Stein[21] posits that the remedy was introduced because the South African government 'recognised the economic necessity to create and foster investor confidence in South African companies by introducing some significant new rights and remedies for minority shareholders, most of which already exist in similar or modified forms in the company laws of most first-world nations.' The international jurisdictions that influenced the inclusion of the appraisal remedy in the Companies Act were primarily, the United States, where the remedy was created for the purpose of recompensing minority shareholders for the removal of the requirement for unanimous shareholder approval and essentially the loss of the ability of minority shareholders to veto proposed fundamental corporate changes.[22] Other countries that have incorporated appraisal rights into statutory law are New Zealand[23] and Canada[24].

However, the third and principal reason that the appraisal rights remedy was introduced was stated in the explanatory memorandum of the Companies Act Bill which stated that the appraisal rights inclusion catered for the reduced role of the courts in the sanctioning of transactions that fundamentally alter a company. In terms of the 1973 Act, fundamental transactions such as a merger, amalgamation or a scheme of arrangement required the court to sanction the transaction for purposes implementation, despite the requisite majority approvals having been obtained. Cassim et al[25] further note that:

> 'The introduction of the appraisal remedy has facilitated a great reduction in the role of the court in fundamental transactions. The appraisal right now functions as the primary protective measure for shareholders in an amalgamation or merger, thereby bypassing the necessity for general court approval of such transactions. In this regard, statutory mergers are not subject to general or automatic court involvement. Instead court involvement is restricted to certain specified circumstances. This new approach applies to the requirement of court approval applies equally to disposals of assets or undertakings of a company under the new Act. The scheme of arrangement procedure has also been reformed, in that the conventional protective measure of

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[21] Carl Stein *New Companies Act Unlocked* (2011) 363.
[22] B Manning op cit note 7 at 614-15.
[23] Section 4 of the New Zealand Companies Act 1993.
[24] Section 184 of the Canada Business Corporations Act 1985.
[25] Cassim 'Contemporary Company Law' op cit note 9 at 675. Prior to the introduction of appraisal rights it was a requirement for the court to approve the merger or amalgamation or scheme of arrangement before it could be implemented. The advent of the Companies Act has replaced the courts role by providing shareholders with the right to appraisal and exit from the company.

judicial sanctioning of schemes or arrangement is now replaced with the appraisal remedy together with the requirement for a report from an independent expert.'

Notwithstanding that court sanction was required before the Companies Act coming into effect, it was a long standing and fundamental principle of company law that the courts will not normally interfere with the affairs of a company and they are not concerned with the commercial aspects of a transaction which has been approved by the requisite majority of shareholders.[26] The courts were only empowered to act only in instances where it could be shown that the minority shareholders are being unfairly prejudiced by the conduct of business of the company and not necessarily where a dissenting shareholder was not content with the affairs or actions of the company or the majority shareholders of such company. Accordingly as a minority shareholder, one was expected to accept the will of the majority in respect of the affairs of the company and the only options in situations of dissent were to either remain as a shareholder or sell his/her shares to another party.

Essentially, the appraisal remedy acts as a protective measure against the rule of the majority. It counters to the company law principle of majority rule as it provides a dissenting shareholder with a mechanism for expressing his/her discontent. It further empowers the dissenting shareholder to compel the company to pay the fair value of his/her investments, expectations, and results in a company despite the inherent risks associated with investing in that company.[27]

2.3. Instances when the appraisal rights remedy arises

The appraisal rights remedy has a restricted number of instances wherein it is triggered. These instances are set out in Chapter 5 of the Companies Act.[28] The right to appraisal in terms of section 164 of the Companies Act will arises when a company proposes to:

- make amendments to the company's memorandum of incorporation which will alter the preferences, rights, limitations or other terms of a class of shares of the company and which will have a resultant effect of materially adversely affecting the rights of shareholders;[29] or

[26] *Investors Mutual Funds Ltd v Empisal (South Africa) Ltd* (1979) 3 S Afr LR 170 at 175 G-H.
[27] JJ Garza Castañeda op cit note 8 at 821. Section 164(14) read with s.164(15)*(c)(ii)* of the Companies Act.
[28] Section 164(2) of the Companies Act. Section 164(1) of the Companies Act explicitly excludes transactions, agreements or offers made pursuant to a business rescue plan that was approved by shareholders of a company in terms of the provisions of section 152 of the Companies Act.
[29] Section 164(2)*(a),* as read with section 37(8) of the Companies Act. It is noted that the Companies Act does not define what constitutes 'materially and adversely' alter.

- Implement or undertake a major transaction, such as a merger (also referred to as an amalgamation) or acquisition, scheme of arrangement, or disposal of all or a large number of the company's assets.[30]

Mergers or amalgamations are regulated by sections 113, 115 and 116 of the Companies Act and it is a mechanism where two or more companies combine to form a single entity which can be either one of the companies involved in the merger or a new entity. Such a transaction requires the companies involved to enter into a merger agreement which is required to include details pertaining to, inter alia, the proposed memorandum of incorporation, the proposed directors of the surviving company or new entity, details of how the shares of the merging companies will be converted into new shares of the resultant entity, the consideration that shareholders will receive instead of receiving shares and details of how the assets and liabilities of the merging parties will be allocated between or amongst them. The merging parties must propose the merger to their shareholders at separate general meetings. A copy or summary of the merger agreement, an extract of sections 115 (required approvals for the merger) and 164 (appraisal rights) are required to be included in the notice of general meeting. Subject to the discretion of the Takeover Regulation Panel, a report by an independent expert on the fair and reasonableness of the transaction may be required.

A scheme of arrangement entails a transaction where the company enters into an arrangement with its shareholders in terms of which the shares of the company may be consolidated with another class, divided into separate classes, expropriated, exchanged, repurchased pro rata from all shareholders or any combination of the above. Approval of a scheme of arrangement, pursuant to the requirements of section 115 (75 per cent shareholder approval) is binding on all the shareholders regardless of whether the shareholder voted in favour of the resolution or not. Depending on the structure of the transaction, the consideration offered to shareholders may be in the form of shares or cash. The board of the company is required to retain the services of an independent expert to compile a report on the fair and reasonableness of the transaction and such report is required to be distributed to the shareholders together with the notice of general meeting containing the provisions of sections 115 and 164 of the Companies Act.

The Companies Act regulates the manner in which disposals or all or a greater part of a company's assets or undertaking should be proposed to shareholders. Section 112, as read with section 115(2)*(b)* of the Companies Act requires the shareholders of a company that is

[30] Section 164(2)*(b),* as read with section 15(5) of the Companies Act.

disposing of its assets, which constitute a greater part of its assets fairly valued, as well as when a subsidiary of the company, having regard to the consolidated financial statement of the holding company, the disposal by the subsidiary constitutes a disposal of all or a greater part of the assets or undertakings of the holding company to vote on the disposal of such assets. The company is required, amongst other information, to provide the shareholders with all the information that pertains to the value of the securities affected by the proposed disposal.[31]

It was contested in the case of *Cilliers v La Concorde* whether in terms of section 115(2)(b) the minority shareholders of the holding company also had the right to seek appraisal as the minority shareholders were not shareholders of the company that was disposing of the assets (i.e. the subsidiary of the company was the one disposing of its assets). The court held that the right to exercise appraisal rights was available to both the shareholders of the holding and the subsidiary company as 'to treat the dissenting shareholder in the holding company any differently…would undermine the clear purpose of minority shareholder protection embodied in the policy and Act.'[32]

The transactions stated above, pursuant to section 115 of the Companies Act require a 75 per cent special resolution to be passed by the requisite number of shareholders of a company in order to be implemented. The appraisal right is reserved for these instances because these actions by the company have the potential to adversely alter the shareholders' investment and general shareholding in the company.[33] The emphasis of how these fundamental transactions can affect a shareholder's investment can be seen in how an amalgamation or merger, a disposal of a greater part of assets and a scheme of arrangement require the regulated company to approach the Takeover Regulation Panel for a ruling on whether a fair and reasonable opinion on the proposed transaction should be provided by an independent expert.

The fundamental transactions set out above only require the involvement of the court in instances where more than 15 per cent of the shareholders vote against the resolution to approve the disposal, amalgamation or merger or scheme of arrangement and any of the shareholders that voted against the resolution demands that the company seek court approval prior to

[31] Section 112(3)(a) of the Companies Act.
[32] *Cilliers v La Concorde* supra note 5 para 47.
[33] Davids et al op cit note 16 at 352.

implementing the resolution.[34] The court may also grant leave to a shareholder that voted against the resolution to have the transaction reviewed prior to the company implementing the transaction.[35]

If a dissenting shareholder cannot rely on the above mechanisms for the court to approve or review the transaction, or should the dissenting shareholder simply want to exit the company, the dissenting shareholder has available to him/her the appraisal right remedy to have the fair value of his/her shares judicially determined by the courts. Effectively the appraisal right remedy provides a dissenting shareholder with an additional mechanism of having his/her matter heard by the courts.[36]

2.4. Procedure for enforcement of the appraisal rights remedy

The procedure for the enforcement of appraisal rights is set out section 164 of the Companies Act and the procedural requirements may appear at quick glance, with respect, to be cumbersome,[37] as the dissenting shareholder is required to adhere to the time requirements and perfect the action of each step. Should a dissenting shareholder fail to complete the required actions consecutively and within the timeframes set out in the Companies Act, the dissenting shareholder loses his/her rights to appraisal. So as to ensure that shareholders are advised of their right to appraisal, the company is required to provide a shareholder with a circular that contains all relevant information in respect of the proposed fundamental transaction and relevant resolutions through the distribution of a circular incorporating a notice of general meeting notice of the proposed fundamental transaction.[38] The circular must also contain a

[34] If a shareholder has made an application to the court in terms of section 115(3)(a) the company must either apply to the court for the approval or consider the resolution a nullity. The company is required to bear the costs for its court application process.

[35] The court can only set aside a resolution that a shareholder has been granted leave for application for a review if upon the review of the transaction, the court may set aside the resolution only if it is 'manifestly unfair to any class of holders of the company's securities; or 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.

[36] Cassim et al 'Contemporary Company Law' op cit note 9 at 676 argues that it may have been beneficial for the legislature to have maintained the requirement for court approved schemes of arrangements as this would have avoided the need of appraisal rights. He argues that appraisal rights diminish the practical benefits of a court approved schemes of arrangements because they result in a cash drain on companies when they are enforced.

[37] *Juspoint Nominees v Sovereign Foods* supra note 4 para 20.

[38] Section 164(2)(b) of the Companies Act. The extent of the information that must be provided to shareholders in a circular is set out in the Companies Act and the Companies Regulations. Prior to the circular and notice of general meeting being posted to shareholders, the circular needs to be approved by the Takeover Regulation Panel, if the company is a regulated company and by the Johannesburg Stock Exchange Limited, if the company

statement informing shareholders of their rights under section 164 or an extract of section 164 of the Companies Act as a whole.[39]

From the time of receipt of the notice, any shareholder that dissents to the proposed fundamental transaction can give the company written notice expressing his/her dissent and objection to the proposed transaction. The objection notice must state the shareholder's intention to enforce his/her appraisal rights in the event of the resolution approving the fundamental transaction being approved at the upcoming general meeting.[40] The section does not state whether or not a dissenting shareholder must provide any reasons for the objection. No action is required from the company following receipt of the notice of dissent. The company's right to proceed with holding a shareholders meeting is not affected.

In order for a dissenting shareholder to successfully enforce his/her appraisal rights, the dissenting shareholder must comply with the procedural requirements stated in section 164(5) of the Companies Act, which require a dissenting shareholder to give notice of his/her objection to the resolution pertaining to a fundamental transaction (as stated above), not to withdraw such objection and to vote against the resolution at the meeting of shareholders.41 At the meeting of shareholders, should the company receive majority shareholder approval in respect of the proposed transaction, and proceed to adopt the transaction resolution, the dissenting shareholder is required to make a demand to be paid fair value of his/her shares.42 The demand is the essential step in the procedure as it is the step that perfects the appraisal right.[43]

When a dissenting shareholder makes his/her demand to the company, the rights of the dissenting shareholder in the company are curtailed, the dissenting shareholder no longer has full shareholder rights in that company and only becomes entitled to the payment of the fair

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is a listed company. In this regard the circular is reviewed and approved by these regulatory bodies to ensure that the shareholders will be provided with all relevant details of the transaction, of their rights.

[39] Section 164(2) of the Companies Act.

[40] Section 164(3) of the Companies Act. This objection may be provided to the company anytime from the time of posting of the notice of general meeting up until immediately prior to the general meeting. It is from this point that the company becomes aware of potential dissent to the fundamental transaction by its minority shareholders.

[41] Section 164(3) read with s.164(4)*(b)(i)* and s.164(5)*(c)* of the Companies Act. The demand is required to be delivered to the company within a period of 20 business days from the date of being made aware that the company has implemented the transaction pursuant to section 164(7) of the Companies Act.

[42] Pursuant to section 164(8) of the Companies Act, the dissenting shareholder's notice of dissent must disclose the shareholder's name and address; the number of shares that he/she holds; and make a demand for payment for the fair value of those shares. A copy of the demand must be delivered to the Takeover Regulation Panel as well.

[43] F Cassim *The Practitioner's Guide to the Companies Act 71 of 2008* (2011) 139.

value of his/her shares unless the dissenting shareholder withdraws such demand or the fundamental transaction is revoked by the company. In *Loest v Gendac*[44], Manamela AJ held:

> 'The applicant is still a shareholder for purposes of receiving fair value for his shares. Section 164 does not deprive him of his status as a shareholder, but merely removes other trappings or privileges associated with this status, whilst the applicant as a dissenting shareholder pursues the remedy in terms of this statutory provision.'

The other trappings referred to include the right to receive a dividend from the company as well as to vote on transactions that do not pertain to the transaction that gave rise to the appraisal rights of the dissenting shareholder. In essence the company may proceed with it ordinary course of business while the parties deal with the issue of the dissenter's appraisal rights.

The curtailment of the dissenting shareholder's rights is subject to the dissenting shareholder not withdrawing his/her demand or letting an offer by the company lapse or the company revoking the resolution that gave rise to the shareholder's appraisal rights.[45] In the instance that a dissenting shareholder withdraws his/her demand or an offer by the company lapses, the dissenting shareholder's full rights would be restored and he/she may continue his/her participation in the company with all other shareholders (i.e. be paid the dividends or other distributions that were issued while the appraisal rights were in force). Should the event that triggered the appraisal rights terminate (i.e. the transaction resolution is revoked by a subsequent special resolution of shareholders) the dissenting shareholder's full rights would be restored and reinstated without interruption.

Therefore the rights of the dissenting shareholder are subject to the transaction that gave rise to them being validly approved and implemented according to its terms. Should the proposed transaction fail to be implemented and lapse as a result, the dissenting shareholders' appraisal rights will cease to exist. In the case of *Juspoint Nominees v Sovereign Foods*, Stretch J held that through a failure to fulfil or waive of a condition precedent to the proposed transaction, the scheme of arrangement and the appraisal rights exercised against it had no legal effect and as such the dissenting shareholders' full rights to participate in the subsequent shareholder meeting had been restored and they could not be precluded from voting thereat.[46]

As previously alluded to, the appraisal right remedy provides a dissenting shareholder with the ability to compel the company to pay the fair value of his/her shares at a price that is satisfactory

[44] Supra note 4 para 13.
[45] Section 164(9)(a)-(b) read with section 164(11) and 164(12) of the Companies Act.
[46] *Juspoint Nominees v Sovereign Foods* supra note 4 para 32.

to both parties or have the price determined judicially.[47] Following receipt of a written demand from a dissenting shareholder, a company is required to make an offer to buy back its shares from the dissenting shareholder.[48] The company's offer should be made at a fair value and the company's offer is required to be accompanied by an explanation from the company's directors of how the directors arrived at the value offered and illustrate how such value is considered fair by the directors. The value should be determined as the date immediately preceding the date that the company implemented the transaction.[49]

One would like to point out that in fundamental transactions such as a scheme of arrangement and in some instances amalgamations and mergers, the board of the company is required to appoint an independent expert that is required to opine on whether the price offered by the company to shareholders is 'fair'.[50] The board in most cases relies on the independent expert's report for purposes of recommending shareholders to vote in favour of the transaction and it can be presumed that the valuation of the transaction or the consideration offered thereon made by the independent is what the board of directors considers to be the fair value. As such it would be unlikely that the board of directors would deviate from the valuation stated in the independent expert report when it makes an offer to the dissenting shareholders.

Should the dissenting shareholder accept such offer from the company, the appraisal right will accordingly be perfected as the purpose of the right would have been fulfilled.[51] However, should the company fail to make an offer or the dissenting shareholder is not satisfied with the value offered by the company in respect of his/her shares, the dissenting shareholder may approach the court to determine the fair value of his/her shares.[52] At the judicial proceedings both the dissenting shareholder and company would make factual representations, supported by evidence, of what they consider to be the fair value of the shares. The court is required to make a determination of fair value in respect of the shares and, at its discretion, can appoint

[47]HGJ Beukes (2008) op cit note 5 at 479.
[48] Section 164(11) of the Companies Act. Within 5 business days of the later of effective date of the adopted transaction resolution, last date to receive demands or of the day the company receiving a Demand, the company is required to send a written offer to pay an amount considered by the company's directors to be fair value of the relevant shares, as at the date on which and time immediately before, the company adopted the transaction resolution, accompanied by a statement as to how that fair value was determined.
[49] Section 164(16) of the Companies Act.
[50] Sections 114(2) and 114(3) of the Companies Act as read with regulation 90 of the Companies Regulations.
[51] The offer can be accepted at any time before the court has made an order as to the fair value of the shares.
[52] Section 164(14) of the Companies Act. The court may be approached subject to the offer made by the company not having already lapsed. Section 164(15)(a) requires that all dissenting shareholders be joined as parties to the court proceedings.

one or more appraisers to assist it in the process.[53]

The court is empowered to make an order of payment by the company of what it has determined to be the fair value of the all the dissenting shareholders' shares, allocate costs and compel the dissenting shareholders to tender their shares and for the company to pay the fair value as determined by the court.[54] Interest may be applied to the determined fair value at the court's discretion.[55] Should the court find that the dissenting shareholder's claim has no basis or that he/she has failed to prove the fair value of the shares, the court may compel the dissenting shareholders to withdraw their demand and to accept the company's initial offer.[56]

When the court has made its decision, the dissenting shareholder is required to tender his/her shares to the company and the company is required to make payment of the court determined amount to the dissenting shareholder. Upon finalisation of this process, the appraisal process will come to a conclusion. However, if the company makes an application to the court wherein it states that it reasonably believes that the payment of the amount to the dissenting shareholder would result in the company being unable to pay its debts in the ordinary course of business for the next twelve months, a delayed payment order may be given by the courts.[57]

2.5. Anti-appraisal mechanisms in South Africa

There are several corporate practices that an acquiring party and/or the company may utilise in an effort to limit the appraisal right, which mechanisms include:

a) Avoidance of triggering a fundamental transaction by utilising alternative takeover mechanisms.
b) Entering into vote and support agreements or irrevocable undertakings with certain shareholders of the company.
c) Utilising a condition precedent in the transaction agreement that permits the acquiring party and/or the company has a right to terminate the proposed transaction in the event a predetermined number of dissenting shareholders exercise their appraisal rights.
d) Seeking approval from shareholders for the company to revoke the proposed transaction

[53] Section 164(15)(c)(ii)-(iii)*(aa)* of the Companies Act.
[54] Section164 (15)(c) of the Companies Act.
[55] Section 164(15)(c)(iii)*(bb)* of the Companies Act.
[56] Section 164(15(c)(v)*(aa)* of the Companies Act. The court can essentially determine that the fair value of the shares is the offer price.
[57] Section 164(17) of the Companies Act. The court must ensure that the payment is made at the earliest possible date that is suitable for the company's financial stability.

should a certain number of dissenting shareholders exercise their appraisal rights.

2.5.1. Utilisation of mechanisms that do not trigger appraisal rights

Notwithstanding that the Companies Act has several trigger events when compared to other appraisal statutes in other jurisdictions, the triggering of appraisal rights can be intentionally avoided if the steps of the transaction are structured in a manner that does not fall under the definition of a fundamental transaction in the Companies Act. In South Africa an alternative method to attain control of a company, which does not trigger appraisal rights, is that of a general offer to all shareholders for the acquisition of all or a portion of the company's shares to an extent that provides control to the acquirer in terms of the Companies Act.[58]

Pursuant to a general offer a company can make an offer to all shareholders of a target company instead of using the merger mechanism or a scheme of arrangement for purposes of effecting a change in control of a company. In this regard an offeror would notify the shareholders of the target company of its intention to make a general offer to acquire 100 per cent of the shares of the company and state the price at which it will acquire the shares for. In this regard, the Companies Regulations[59] require the offeror to provide the Takeover Regulation Panel with a cash guarantee or confirmation/proof that it has available to it the funds to purchase all the shares accordingly.

The Companies Act does permit an offeror to make an offer to not acquire all the shares of the shareholders of a company. In this regard the offer will clearly stipulate in its offer the percentage of shares that it wishes to acquire. The offeror can also stipulate the minimum number of shares that it is willing to acquire and should the minimum number of shares not be tendered by the shareholders of the company, the offeror would effectively fall away. One also observes that, in recent practice, a company will simultaneously propose a general offer to shareholders as an alternative, should the proposed resolution for the scheme of arrangement not be approved, or should the company decide to not implement the transaction.[60]

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[58] Regulation 101.

[59] Regulation 101(7)(b)(vi).

[60] An offeror and the offeree company can propose an offer by way of a scheme of arrangement to the offeree regulated company shareholders and, in the event that the scheme of arrangement fails, for the offeror to elect whether to proceed with a standby general offer immediately thereafter. Refer to the following offers: the offer by Associated British Foods plc to the shareholders of Illovo Sugar Limited, announced on 8 April 2016 and the offer by Stellar Capital Partners to the shareholders of Cadiz Holdings Limited, announced on 19 June 2015. The scheme of arrangement and general offer can be proposed concurrently. Refer to the offer by Capitalworks

The Companies Act[61] provides should a person or an existing shareholder acquire (or as a result of a transaction implemented by the company) a beneficial holding in excess of or equal to 35 per cent of the voting rights of a company, that person is obligated to notify the other shareholders of the company and to make an offer to acquire the shares of the remaining shareholders in the company. The offer must be made at a price similar to the price at which the offeror purchased the shares that triggered the mandatory offer. Shareholder approval must be sought should a person not wish to proceed with making an offer to the remaining shareholders.[62] A mandatory offer can be utilised by an offeror as a mechanism of triggering an offer to the other shareholders in order to take control of a company.

The use of the offer mechanisms stated above (general offer and mandatory offer) do not trigger appraisal rights. The reason why appraisal rights are not available is because the shareholders are provided with a choice to either accept or decline the offer by the offeror. The ability to elect whether to exit or to remain with the company provides a dissenting shareholder with the freedom of choice which does not necessitate appraisal rights. It must be noted that the choice of the minority shareholder to not accept the offer diminishes in proportion to the number of shareholders who do accept the offer. The refusal to accept the offer may result in the dissenting shareholder being squeezed out in accordance with section 124 of the Companies Act.

Minority shareholders can be squeezed out or bought out of a company in terms of section 124 of the Companies Act either at their own behest by making a demand to that effect or through the offeror making the decision and subsequent offer to do so. It is envisaged in the Companies Act that a company wherein a single shareholder or concert parties have assumed more than 90 per cent of control of the company, it would be more beneficial for the remaining minority shareholders to be bought-out of the company. In accordance with the provisions of section 124 the offeror is required to make an offer to the remaining minority shareholders which is on the same terms as the offer that was made to the other shareholders. The minority shareholder may make an application to the court objecting to the offerors entitlement to buy out the shareholder; to demand that the offer be made on different terms.

Private Equity (Pty) Limited to Petmin Limited announced on 20 December 2016 and the offer by Capitalworks Private Equity (Pty) Limited to Sovereign Food Investments Limited announced on 10 August 2017.

[61] Section 123 of the Companies Act.

[62] Regulation 86(4).

2.5.2. Entering into support agreements with shareholders

The Takeover Regulation Panel pursuant to its powers under regulation 4 of the Companies Regulations issued a guideline wherein it recognised that in commercial practice it may be necessary for an offeror to approach a number of significant minority shareholders in order to obtain views on the proposed offer and makes provision for only 5 or less shareholders each holding 5 per cent or more to be approached prior to the offer being made public.[63] The discussions undertaken must be kept confidential and is subject to non-disclosure. The provisions effectively permit for a few select shareholders to be made "insiders" in terms of the definition contained in the Financial Markets Act[64] and thus subject to its provisions.

An acquirer usually seeks to reach agreement with these shareholders and will enter into "voting and support", "lock-in" or "irrevocable undertaking" with the shareholder wherein the shareholder undertakes to vote in favour of the transaction when it is proposed at a general meeting. The benefit of shareholder support agreements is that 'it locks in a defined number of positive votes and minimizes the possibility that appraisal will interfere with completion of the deal.' [65]

Yeats posits that an agreement and other shareholder agreements where the shareholder has contractually agreed to not vote against certain corporate transactions have the resultant effect of a shareholder waiving his/her appraisal rights in an anticipated transaction as he/she cannot exercise the appraisal right if he does not vote against the proposed resolution. [66] Technically an express clause stating that the shareholder waives his/her right to appraisal is null as the requirements to gain standing in appraisal litigation is for the dissenting shareholder to have voted against the relevant transaction resolution.

This raises the question of whether a South African shareholder can contractually waive his/her right to exercise his/her appraisal rights in South African law. Section 164 does not state whether or not the appraisal right can be waived, however, section 6 of the Companies Act sets out which rights in the Companies Act are capable of alteration and those which are not. The

[63] Takeover Regulation Panel Guideline 1/2013' Approaching shareholders prior to making a firm intention announcement' 22 August 2013.
[64] Financial Markets Act 19 of 2012.
[65] Audra Boone, Brian Broughman and Antonio J. Macias 'Merger negotiations in the shadow of judicial appraisal' Unpublished working paper (2017)
available at *https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2888420* accessed 18 May 2018 at 25.
[66] J Yeats op cit note 7 at 213.

appraisal right is an unalterable right in terms of the Companies Act and pursuant to this the provisions of section 6 of the Companies Act apply.[67]

However, it can be argued that the provisions of section 6 of the Companies that make appraisal rights an unalterable right extend to restricting companies from having provisions in their memoranda of incorporation that would limit the rights of all shareholders from exercising appraisal rights. Accordingly, in instances where the shareholder contractually enters into an agreement with an acquirer to waive his/her appraisal rights, it can be argued that the anti-avoidance provisions of the Companies Act would not deprive a shareholder with a right to enter into a voter support agreement or irrevocable undertakings as this would be contrary to the principle of freedom of a party to contract in law. This is in line with the TRP's view in respect of irrevocable undertakings entered into by shareholders. In the Takeover Special Committee ruling in *Goldfields Limited v Harmony Gold Mining Company Limited and Norilsk Nickel*,[68] albeit ruling on whether irrevocable undertakings resulted in a shareholder acting in concert with the company, wherein it ruled that an irrevocable undertaking entered into by a shareholder was an act of a shareholder merely acting as an investor to maximise the value of its investment and accordingly the shareholder was pursuing its own interests.

Contract law provides that a person may contractually renounce a right that has been conferred upon him by law for his own benefit.[69] This can be done through a waiver of 'a right, remedy, privilege or power or an interest or benefit.'[70] For purposes of a waiver to be valid in terms of the law the waiver must be made by a person with full knowledge of his/her right, such person must decide to abandon it expressly or through conduct that is indicative of an intention not to enforce it.[71] As such it can be presumed that in order for a waiver of appraisal rights agreement

[67] Section 6(1)(a) and (b) of the Companies Act. Section 6 makes provision for the Companies Commission, Takeover Regulation Panel or stock exchange in respect of a listed company to make an application to the court to declare any agreement, transaction, arrangement, resolution or provision of a company's memorandum of incorporation or rules to be primarily or substantially intended to defeat or reduce the effect of a prohibition or requirement established by or in terms of an unalterable provision of the Companies Act; and void to the extent that it defeats or reduces the effects of a prohibition or requirement established by or in terms of an unalterable provision of the Companies Act.
[68] Takeover Regulation Panel ruling given on 28 November 2004 9 (*Goldfields Limited v Harmony Gold Mining Company Limited and Norilsk Nickel – Reasons for the Ruling of the Panel given on 28 November 2004*) available at *http://www.trpanel.co.za/wp-content/uploads/PDFs/reasonsFeb05.pdf* accessed on 19 June 2018.
[69] *Ritch and Bhyat v Union Government (Minister of Justice)* 1912 AD 719 at 734-735. See also *Morrison v Anglo Deep Gold Mines Ltd* 1905 TS 755 at 781-782.
[70] *Road Accident Fund v Mothupi* 2000 4 SA 38 (SCA) para 15.
[71] *Laws v Rutherford* 1924 AD 261 at 263. See also: *Alfred Mc Alpine & Sons (Pty) Ltd v Transvaal Provincial Administration* 1977 (4) SA 310 (A) at 323-4.

to hold water it would need to be concluded with a sophisticated shareholder that can be presumed to have fully been aware of his/her right to appraisal rights in the event of a triggering transaction being proposed. The appraisal right is conferred by the Companies Act and in order for a shareholder to waive such a right, as stated above, the right must be for the sole benefit of the dissenting shareholder. This means that as a statutory right, the appraisal remedy must not have the function of serving a public interest.

The extent to which one can expressly waive their statutory rights in South African law is limited. An agreement wherein a party attempts to waive the benefits conferred by law can be deemed to be unenforceable by the court if it is held to be against public policy or public interest on the basis that it seeks to deprive the dissenting shareholder of a protection which was conferred upon him as a matter of policy. This principle was endorsed in the case of *Sasfin (Pty) Ltd v Beukes*[72] and has been a referred to several cases thereafter. In *Leech and others v ABSA Bank Limited*[73] it was held that:

> 'Private contracts are not permitted to render sufficient between themselves that which the law declares essentially insufficient or to impair the integrity of a rule necessary for the common welfare.'

The court will not callously declare a term of a contract to against public policy. Smalberger JA held that:

> 'The power by the court should be exercised sparingly and only in the clearest of cases, lest uncertainty as to the validity of contracts result from an arbitrary and indiscriminate use of the power. One must be careful not to conclude that a contract is contrary to public policy merely because its terms (or some of them) offend one's individual sense of propriety and fairness.'[74]

A balance must be struck between the public principle of freedom of contract and that of public policy. In determining whether a contract is against public policy or public interest, the court considers the tendency of the proposed transaction and not its proven result.[75] To this end, the court will consider the applicable provisions of the relevant statute and should this not provide

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[72] 1989 (1) SA 1 (AD).

[73] 1997 3 All SA 308 (W).

[74] *Sasfin v Beukes* supra note 142 para 8.

[75] D Hutchinson, B van Heerden, DP Visser and CG van der Merwe *Wille's Principles of South African Law* 8ed 431.

clarity on the possibility of waiver, the court will refer to the purpose for which the statutory provision was legislated and the preamble of the statute.[76]

The Companies Act confers a shareholder of a company, that has proposed a fundamental transaction in which the right arises, with a right to make a demand to be paid the fair value of his/her shares for purposes of exiting the company. It must be noted that the United States does not have an anti-avoidance provision similar to section 6 in its company law. Should the unalterable nature of appraisal rights not suffice as a determinant of whether the waiver of the right is against public policy an enquiry into the purpose of the right can be undertaken.

With regard to the purpose of the provisions enacted in section 164 of the Companies Act, in the case of *Cilliers v La Concorde*, the court considered an article by Yeats and quoted in agreement with her argument that the objective of the appraisal right remedy was to effectively provide a statutory exit mechanism for minority shareholders which negated the need to find a willing buyer by obliging the company to become the purchaser but also empowered the shareholder to insist on a price that it considered a fair price which may ultimately be determined by the court.[77] Papier JA[78] further held that taking into account the purpose of appraisal rights (a mechanism to protect all shareholders with voting rights, it was an express policy objective of appraisal rights to provide an exit and to provide smaller investors with the ability to make informed choices in instances where they cannot influence the direction of the company to pursue civil litigation against the company.

In light of the above, it can be argued that the South African courts could consider the waiver of appraisal rights to be unenforceable on the basis that the effect of such waiver would erode the protection that the legislature sought to provide to dissenting shareholders and to be against public policy and public interest. This may extend to shareholder agreements and irrevocable undertakings signed between shareholders and/or with the company, which have the indirect effect of waiving the contracting shareholder's appraisal rights in terms of the Companies Act. This is based on the approach of the South African courts to date, which has been to apply a

[76] *SA Eagle Insurance Co Ltd v Bavuma* 1985 (3) SA 42 (A) para 49G-H.
[77] *Cilliers v La Concorde* supra note 5 para 34.
[78] Supra para 43-46. The court took into consideration several academic authorities on appraisal rights as well as the General notice No: 26493 notice 1183 of 2004 South African Company Law for the 21st Century: Guidelines for Corporate Law Reform; May 2004, which was identified as the policy document that underpinned the Companies Act. The court also took into consideration the 2007 Company's Bill for purposes of establishing the intentions of the legislature.

purposive interpretation to the application of the provisions of the Companies Act and to endeavour to maintain the protective measures aspired to by the Companies Act.

2.5.3. Appraisal Right Conditions Precedent

In less than a year following the introduction of the appraisal rights remedy into South African law in 2011, corporate practitioners introduced appraisal rights conditions into common practice as a mechanism for managing the impact of appraisal rights in a proposed transaction.[79] This is a practice which was also adopted from the United States, wherein parties to a transaction include a clause in the transaction agreement called "an appraisal out clause." A condition in an agreement is a contractual provision that states upon the occurrence of an uncertain future event, an obligation shall either come into effect or be discharged.

Contemporary corporate practice in South Africa indicates that when companies are undertaking a fundamental transaction, the terms and conditions of the transaction usually include an appraisal right condition precedent.[80] An appraisal condition precedent provides the company or the acquirer with an option to remove itself from the transaction in the event that the proposed transaction is threatened by the exercise of appraisal rights upon implementation. An appraisal right condition precedent also works to the benefit of the target company in that

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[79] In the circular to CapeVin Investments Limited published 8 June 2012 the first appraisal condition precedent in South Africa was included as a term of the scheme of arrangement offer made by Capevin Holdings Limited. See also Ann Crotty 'CapeVin offer shows how to neutralise dissenters' rights' *The Business Day* 17 April 2012 available at *https://www.iol.co.za/business-report/economy/capevin-offer-shows-how-to-neutralise-dissenters-rights-1277283* accessed 23 March 2016.

[80] Refer to the scheme of arrangement circular sent to Clicks Group Limited shareholders dated 19 December 2013 at 18 available at *https://www.clicksgroup.co.za/IRDownloads/AnnualResults2013/ClicksGroupCircular.pdf* accessed on 30 May 2017; combined scheme of arrangement circular to Mvelaserve Limited shareholders dated 23 August 2013 at 19 available at *https://www.jse.co.za/content/JSECircularItems/20130829-Mvelaserve%20Limited%202013.08.23%20Circular%20to%20shareholders%20(Bidvest).pdf* accessed on 30 May 2017; scheme of arrangement circular to Steinhoff International Holdings Limited shareholders dated 7 August 2015 at 11 available at *http://www.steinhoffinternational.com/downloads/2017/STEINHOFF%20CIRCULAR%207%20Aug%202015.pdf* accessed 9 September 2017; scheme of arrangement circular to Sekunjalo Technology Solutions Limited shareholders dated 30 January 2017 at 27-28 available at *http://aeei.co.za/wp-content/uploads/2017/01/Sekunjalo-Technology-Solutions-Circular-30-January-2017.pdf* accessed 9 September 2017; combined circular to Petmin Limited shareholders dated 3 April 2017 at 36 available at *http://www.overend.co.za/download/circular03042017.pdf* accessed 30 May 2017; the combined scheme of arrangement circular sent to Moneyweb Holdings Limited shareholders dated 14 June 2017 at 17 available at *http://ame.co.za/Circular_Final_2017.PDF* accessed 9 September 2017; the combined scheme of arrangement circular sent to Sovereign Food Investment shareholders dated 7 September 2017 available at *http://www.sovereignfoods.co.za/files/library/reports/2834dfde003e563948db05e23ed77a46.pdf* accessed 9 September 2017.

the condition can provide the target with a right to walk away from the transaction if the acquirer does not waive its rights in terms of the clause by a stipulated date.

Alternatively, this condition precedent also provides the company or acquirer with a mechanism to negotiate with the dissenting shareholders and increase the consideration offered, subject to how the condition precedent is drafted. In these instances, a condition precedent of merger, disposal or scheme of arrangement will include a condition that should a certain number of shareholders or a specified percentage of votable shares of the company exercise their appraisal rights, the company or the other party to the fundamental transaction will have the waiver-able right to renegotiate the transaction terms or to exit the transaction in its entirety.

Such a condition precedent is included for purposes of managing the risk and uncertainty associated with the potential enforcement of appraisal rights which may result in the company or acquirer paying an appraised price which is higher than the transaction negotiated price. [81] Depending on the number of shares subject to appraisal, the fair value for the dissenting shareholders' shares may end up being more or less than the offered consideration and the ligation process may inflate the transaction costs for the company or the acquirer. The specified number or percentage of shares stated in the appraisal condition precedent is usually negotiated by the parties to the transaction and typically is set at 10 per cent-20 per cent or less. The condition usually has a timeframe which spans over the period that dissenting shareholders are required to have submitted their objection to the fundamental transaction or until the lapse of the timeframe wherein the dissenting shareholder should submit his/her demand.

However, the appraisal right condition can also increase the risk of appraisal rights being exercised as the condition can be used as a tool by the dissenting shareholders to ensure that the transaction does not close and is not implemented. The appraisal right condition can provide dissenting shareholders with unintended leverage against the parties and tilt the negotiating dynamics between the parties when negotiating the condition's threshold as this will determine the success of the transaction.[82] In this regard a notice of objection and/or demand from a dissenting shareholder can have the result of immediately terminating the proposed

[81] Christopher S Harrison *Make the Deal: Negotiating Mergers and Acquisitions* (2016) 113 -114. See also Lou Kling, Eileen Nugent, Brandon Van Dyke *Negotiated Acquisitions of Companies, Subsidiaries and Divisions* (2018) 14-26.

[82] C Boyd 'Appraisal arbitrage: Closing the floodgates on hedge funds and activist shareholders' 2016 65 *University of Kansas Law Review* 497 – 529 at 520.

fundamental transaction and forcing the company to withdraw from further considering such a transaction.

The utilisation of appraisal right conditions precedent limits the exercise of appraisal rights because it 'suspends the exigible content of a contract pending the fulfilment or non-fulfilment of the condition.'[83] The non-fulfilment of the appraisal right condition (i.e. the exercise of appraisal rights by more than the prescribed percentage) will terminate the fundamental transaction and the appraisal rights under it. However, the condition precedent may allow for one of the parties (usually the acquirer or company) to unilaterally waive this condition. Where a party has a right to waive the condition, the court in *Juspoint Nominees v Sovereign Foods* noted that the waiver of such a condition precedent must occur prior to the date stipulated as the last date for waiver and the waiver must be communicated to the other parties and the shareholders.[84]

An appraisal condition precedent is permissible under a fundamental transaction and is primarily found in transactions where the offer consideration is not cash.[85] The condition precedent cannot, however, be restrictive of shareholders' appraisal rights and should a condition precedent be too restrictive, it can be challenged in terms of section 6 of the Companies Act. A challenge in terms of section 6 cannot be instituted by a shareholder and would have to be instituted by the Takeover Regulation Panel, Competition Commission or an exchange such as the JSE. The dissenting shareholder seeking to challenge an appraisal right condition on this basis would have to successfully approach these institutions for a court decision to be obtained.

An appraisal condition precedent can effectively be struck down if it makes it impossible for a dissenting minority shareholder to exercise his/her appraisal rights and if it can be shown that the condition is primarily or substantially intended to defeat or reduce the effect of appraisal rights which are rights established by an unalterable provision of the Companies Act.[86] In addition, although it remains to be determined by the courts, in light of the provisions of section 6 of the Companies Act, the appraisal right is not waiver-able in advance whether in terms of

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[83] *Juspoint Nominees v Sovereign Foods* supra note 4 para 23. *Ming-Chich Sheng v Meyer* 1992 (3) SA 496 W at 497H-J.
[84] *Juspoint Nominees v Sovereign Foods* supra note 4 para 31-36.
[85] Stein op cit note 21 at 304.
[86] Yeats op cit note 12 at 339.

the company's memorandum of incorporation.

2.5.4. Revocation Resolutions

Section 164(9)*(c)* of the Companies Act provides the company with a way of diffusing an appraisal situation through the mechanism of having the majority shareholders vote in favour of revoking the resolution which gave rise to the advent of the appraisal right. For purposes of overriding the majority shareholder's initial decision to approve the transaction, a subsequent resolution may be proposed by the company. Should the revocation resolution be approved by the majority shareholders, the appraisal rights of dissenting will cease to exist and their rights as shareholders of the company will be re-instated without interruption.

The rights of a dissenting shareholder in a company are curtailed following making the demand in that he/she will be entitled to the benefit of those shares as at the date of the demand only. This means that the dissenting shareholder will not be entitled to any distributions made by the company after the demand is made. However, it must be noted that the dissenting shareholders will still have a right to vote in the instance that the company decides to revoke the fundamental transaction as a result of the dissent received from minority shareholders. It was held in the case of *Juspoint Nominees v Sovereign Foods*[87] that the dissenting shareholders who had exercised their rights could not be precluded from voting and participating in another general meeting where the company sought to revoke or amend the fundamental transaction resolution that propelled their further actions. Mashabane[88] adds that:

> 'The courts will adopt an equity-based approach when deciding on matters such as these which means effectively that companies cannot use technical arguments to deny minority shareholders the right to participate in the affairs of a company including exercising or withdrawing their appraisal rights.'

As a drafting mechanism, it has become common practice for a company at the time of proposing the transaction to shareholders at a general meeting to include an additional resolution to the fundamental transaction that allows the company to revoke the approved transaction resolution in terms of section 164(9)*(c)* of the Companies Act. The revocation of the transaction would be subject to in the event that any of the conditions precedent to the transaction are not fulfilled or waived. The dissenting shareholder, although his rights in the

[87] *Juspoint Nominees v Sovereign Foods* supra note 4 para 67-69.

[88] B Mashabane 'Appraisal rights and protection of minority shareholders' 2016 *De Rebus* available at *http://www.derebus.org.za/appraisal-rights-protection-minority-shareholders/* accessed 2 February 2017.

company have been curtailed, holds an interest in the revocation of the resolution that gave rise to the appraisal right during this time and such would be entitled to vote on the matter.

The effect of the revocation resolution if adopted by the company would be to revoke the transaction resolution in its entirety. As such the revocation resolution cannot be used as a means of amending the terms of the fundamental transaction.[89] The company would have to go back to the drawing board, restructure the transaction, reconsider the value offered per share and re-propose the transaction to shareholders.

2.6. Conclusion

It can be observed that the process for enforcing one's appraisal rights can be potentially complicated, costly and time consuming. The procedural requirements that are imposed on the company are significantly less than those required of a dissenting shareholder. The dissenting shareholder carries most of the burden in ensuring that there is procedural compliance.

The anti-appraisal mechanism of utilising a non-triggering takeover mechanism for purposes of effecting a transaction is the most effective anti-appraisal mechanism as it has the effect of fundamentally altering the control of the company but does not provide a dissenting shareholder with appraisal rights. Pursuant to this anti-appraisal mechanism, the dissenting shareholder is forced to accept the offer or remain in the company, with the effect that both choices do not afford the dissenting shareholder the opportunity to contest the fairness of the price offered. The mechanism essentially circumvents the purpose of the appraisal rights remedy which is to be paid fair value for ones shares.

The anti-appraisal mechanism of utilising vote and support agreements also has the effect of neutralising the appraisal right of the shareholder that enters into such an agreement. The appraisal right is neutralised in that the shareholder essentially waives his/her ability to participate in the appraisal process which requires a dissenting shareholder to vote against the appraisal provision.

The last two anti-appraisal mechanisms of appraisal rights conditions precedent and of revoking of the transaction resolution have the direct effect of terminating the transaction. This

[89] *Juspoint Nominees v Sovereign Foods* supra note 4 held that 'there is no second bite at the cherry. Once the resolution has been approved, it is above and beyond any form of challenge whatsoever.'[89] A transaction approved by a resolution requires that the shareholders further approve its revocation through a shareholder vote. For purposes of not having to call another meeting for this purpose, companies have started the practice of including a revocation resolution in the notice to shareholders.

may be considered a "win" for the dissenting shareholder when the condition is triggered or when the transaction fails to close as the company will not be capable of proceeding with the transaction. However, such a provision may have a negative effect of other minority shareholders that were supportive of the transaction and thus result in the unintended consequence of the appraisal remedy working against minority shareholders.

In all instances of the use of anti-appraisal mechanisms the purpose of the appraisal remedy, which is to protect minority shareholders is not fulfilled.

CHAPTER 3: APPRAISAL RIGHTS AND ANTI-APPRAISAL MECHANISMS IN THE UNITED STATES

3.1. Introduction and background

As there is limited appraisal right jurisprudence in South African law, pursuant to section 5(2) of the Companies Act which provides that 'to the extent appropriate, a court interpreting or applying the Companies Act may consider foreign company law', it would be expected that a court adjudicating over appraisal rights of a dissenting shareholder would refer to foreign jurisprudence.

The jurisprudence of the United States is a useful comparative as the United States has an extensive history of appraisal right litigation that extends over almost a hundred years. As previously stated the appraisal rights remedy originated in the United States and has been incorporated in the legislation of other countries which include Canada, New Zealand and South Africa. In the United States, the incorporation of appraisal rights into individual state legislation began in the late 19th century and was initially adopted by a few states, however during the first half of the 20th century majority of the states had adopted one variation or another of statutory appraisal rights into their company law.[90]

The statutory law of these states is similar with regard to the purpose of appraisal rights, save for differences in certain instances. The state legislation pertaining to appraisal rights is primarily influenced or derived from The Model Business Corporations Act and the Delaware General Corporation Law, which are considered to be templates of corporate law.[91] It is apparent that the South African appraisal remedy as contained in the Companies Act is derived from both the Model Business Corporation Act and the Delaware General Corporation Law, however, the Companies Act has key differences when compared to both statutes. This research will only refer to these statutes for purposes of this research.

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[90] M Siegel (2011) op cit note 7 at 231. See also L Tran and V Vrublevskaya 'Dissenting shareholder appraisal rights and shareholder oppression claims: Similarities and differences in securities valuation' Autumn 2015 *Shareholder Dispute Litigation Insights* available at *http://www.willamette.com/insights_journal/15/autumn_2015_2.pdf* , accessed on 27 September 2017.

[91] M Siegel (2011) op cit note 7 at 231.

3.2. Legal Framework in the United States

The Model Business Corporations Act is a model statute that is prepared by the Committee on Corporate Laws of the American Bar Association and was first promulgated in 1950.[92] States may adopt some or all of the Model Business Corporations Act's provisions as it acts as the guideline for State corporate law. Appraisal rights are provided for in section 13 of the Model Business Corporations Act, which makes provision for a dissenting shareholder to demand the fair value of their shares in instances where a corporation undertakes several corporate actions (discussed further below). The Delaware General Corporation Law is the corporate statute of the state of Delaware, however, a number of states have utilised the Delaware General Corporation Law as the basis of their own corporate statutes.[93] Section 262 of the Delaware General Corporation Law makes provision for appraisal rights to dissenting shareholders of companies incorporated in Delaware that is undertaking a merger or consolidation in accordance with the Delaware General Corporation Law.

Despite the Model Business Corporations Act and Delaware General Corporation Law having a symbiotic relationship in that they make provision for appraisal rights in the United States, there are material differences between the two pieces of legislation with regard to the language, structure and approach to appraisal rights.[94] The material differences between the Model Business Corporations Act and the Delaware General Corporation Law are with regard to the transactions that trigger appraisal rights, the market out exception (explained further below), timing of the payment of the fair value of shares and the allocation of trial costs.

3.3. Trigger events under the Model Business Corporations Act and the Delaware General Corporation Law

The Model Business Corporations Act, similar to the South African Companies Act, provides for several instances wherein appraisal rights are triggered, which include, inter alia, amendments to a company's articles of incorporation[95], mergers[96], disposition of assets (similar

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[92] John F Olson & Aaron K Briggs 'the Model Business Corporation Act and corporate governance: an enabling statute moves toward normative standards' (2011) 74 *Law and Contemporary Problems* 31-44 at 31.

[93] A large number of companies are incorporated in the state of Delaware.

[94] M Siegel (2011) op cit note 7 at 231-232. See also: JM Gorris, L Hamermesh and L Strine Jnr 'Delaware corporate law and The Model Business Corporation Act: A study in symbiosis' (2011) 74 *Law and Contemporary Problems* 107-120 at 109.

[95] Refers to instances where the share capital of a class of shares is reduced to a fraction of a share if the corporation has an obligation or right to repurchase the fractional share portion.

[96] Appraisal rights are limited to mergers where shareholder approval is required and to shareholders whose shares would be affected by the merger (i.e. excludes shareholders whose class of shares would remain

to disposals of assets), share exchanges, conversions (change in structure into a non-profit entity or into an unincorporated entity), domestication (re-location of place of incorporation) and any other instance of the above stated corporations which are specifically provided for in a corporations articles of incorporation, by laws or a resolution of the board of directors.

In contrast, the Delaware General Corporation Law only provides the appraisal remedy to shareholders when certain mergers and consolidations are implemented.[97] The Delaware General Corporation Law does, however, make provision for a corporation's articles of incorporation to extend the applicability of appraisal rights to other corporate actions, subject to the procedure for enforcement of such extended trigger events being in line, to the extent possible, with the procedure set forth in the Delaware General Corporation Law.[98] The Companies Act does not make provision for a company's memorandum of incorporation to extend appraisal rights to other corporate actions, however, it expressly states that appraisal rights will not be applicable in any transactions which are undertaken in terms of business rescue proceedings.[99]

The Model Business Corporations Act and the Delaware General Corporation Law each contain a limitation to the applicability of appraisal rights to shareholders of publically listed entities termed the 'market out exception'. The Model Business Corporations Act specifically excludes the application of appraisal rights to instances where the company's shares 'are traded in an organized market and has at least 2,000 shareholders and a market value of at least $20 million'.[100] The Delaware General Corporation Law has a similar provision, which also excludes shares that are either (i) listed on a national securities exchange or (ii) held of record

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outstanding following the conclusion of the merger) and to shareholders of a subsidiary of the corporation that is a party to the merger.

[97] The Delaware General Corporation Law specifically excludes mergers where the company issues less than 20% of its shares and mergers where a vote is not required from shareholders of the surviving parent company which is commonly referred to as short form merger. Pursuant to the 2018 amendments to the Delaware General Corporation Law, appraisal rights do not apply to intermediate or medium form mergers, which do not require a shareholder vote for a merger as a result of the offeror acquiring the company's shares through a tender or exchange offer prior to the merger.

[98] Section 262(c) Delaware General Corporation Law.

[99] Section 164(1) of the Companies Act.

[100] The value of the shares is calculated exclusive of the value of such shares held by the corporation's subsidiaries, senior executives, directors and beneficial shareholders owning more than 10% of such shares. Section 13.02 of the Model Business Corporations Act in addition excludes shares that are a covered security under section 18(b)(1)(A) or (B) of the Securities Act of 1933, as amended and shares which are issued by an open end management investment company registered with the Securities and Exchange Commission under the Investment Company Act of 1940 and may be redeemed at the option of the holder at net asset value.

by more than 2 000 holders. However, it will be discussed later in this chapter that there are certain instances where the market out exception is not applicable in both the Model Business Corporations Act and the Delaware General Corporation Law.

The premise of a market out exception is that a dissenting shareholder has the means of exit through selling on the market (liquidity) and that the fair value of the shares is determined by the market value of the shares on the exchange which they trade. It is assumed that in situations where shares are listed on an exchange, a dissenting shareholder can simply sell his/her shares on the market, if the shareholder wishes to exit from his/her investment in the company.[101] The presumption and reasoning for this exclusion in both statutes is that it is only where shares are not listed on an exchange or there are fewer than 2000 shareholders, a dissenting shareholder would struggle to sell his/her shares as in most instances the only willing buyer is the majority shareholder or another minority shareholder.[102]

There is a debate regarding the fairness of a market out exception and whether the market price is the fair value of shares. The proponents for the market out exception argue that the exclusion of publically traded shares is justified because '…the market adequately values stock…[and] contend that appraisal is redundant for shares of publically traded companies because shareholders may obtain the appropriate value by selling on the market.'[103] It has been argued by some scholars that the market out exception results in dissenting shareholders of listed companies not receiving fair value of their shares because it is premised on the assumption that the market fairly values the price of the shares.[104] The opponents to the market out exception argue that:

> "[M]arket value and fair value are not necessarily synonymous under all circumstances…the market may be "demoralized," be reflective only of publically available information, or only a mirror of the transaction price, rather than of the stock's fair value."[105]

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[101] Jeff Goetz 'A dissent dampened by timing: How the stock market exception systematically deprives public' (2009) 15 *Fordham Journal of Corporate & Financial Law* 771-806 at 776.
[102] Stein op cit note 21 at 298.
[103] J Goetz op cit note 101 at 777.
[104] Proponents for the market-out except rely on the Efficient Capital Markets Hypothesis which is of the view that the traded share price of listed shares is reflective of the fair value of the shares and this makes appraisal of such shares redundant. See also E Fama 'Efficient capital markets: a review of theory and empirical work' (May 1970) 25 *The Journal of Finance* 383. See BM Wertheimer 'The shareholder's appraisal remedy and how courts determine fair value' (1998) 4 *Duke Law Journal* 613-716 at 633 n.103.
[105] M Siegel (2011) op cit note 7 at 247.

Wertheimer[106] , the main opponent to the market out exception, argued that:

> Legislatures that have enacted appraisal statutes without market exceptions appear to have recognized that the market does not always adequately protect minority shareholders, and that minority shareholders cashed out at a price at or above the market price may require additional protection. There are, in fact, good reasons why reliance on market price does not adequately protect the interests of minority shareholders.

Another factor that affects the reliability of the market value received by shareholders who are affected by a market out exception is that the shareholders will only be able to sell their shares following the announcement of the proposed transaction. This means that the market value that can be attributed to their shares is influenced by the reaction of the market to the news of the proposed transaction. Goetz[107] argues that this deprives dissenting shareholders of the fair value of their shares 'because they cannot sell their shares at a price that does not include some values derived from the expectation of the merger' and based on an empirical study he determines that 'dissenting shareholders of a publically-traded surviving company must usually sell their shares on the market at a price lower than the price before the announcement.'

It must be noted that although majority of the states apply the market out exception, it is not applied in some state jurisdictions.[108] In the states that the market out exception is applied, it is applied to different circumstances than those of the Model Business Corporations Act and the Delaware General Corporation Law.

It is however recognised by both the Model Business Corporations Act and the Delaware General Corporation Law that there are some circumstances in which the market out exception should not apply (i.e. appraisal rights will be available to shareholders of a company that is listed on an exchange or held of record by more than 2 000 holders). The Model Business Corporations Act provides appraisal rights to shareholders of a publically listed company in instances where the corporate action is an interested transaction as a result of one of the parties (i.e. the management of the listed entity or the offeror) has a conflict of interest in the transaction.[109] The Delaware General Corporation Law provides for appraisal rights to

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[106] BM Wertheimer op cit note 104 at 635.

[107] J Goetz op cit note 101 at 795.

[108] Gilbert Matthews 'Public shareholders, fair value, and the "Market-out exception" in appraisal statutes' available at *https://www.researchgate.net/publication/272818385_Public_Shareholders_Fair_Value_and_the_'Market-Out_Exception'_in_Appraisal_Statutes* accessed on 5 August 2018.

[109] Section 13.02(b)(4) of the Model Business Corporations Act. It is interesting to note that in 1978 the Model Business Corporations Act deleted the market out exception but reintroduced the provision in 1999 with the interested transaction exemption. Siegel (2011) op cit note 7 at 247 posits that the Committee recognised that

shareholders of a listed company in instances where the shareholders are required to accept cash upon the implementation of the transaction.

These exceptions to the market out exception are provided to shareholders because, in respect of the Model Business Corporations Act, interested transactions are not at arms-length and this may have an effect on the liquidity and reliability of the valuation of the shares. The Model Business Corporations Act recognises that the market price of the shares of the company may be subject to an undue influence when the company's majority shareholders, directors or management have an interest in the successful implementation of the transaction and such undue influence may have a negative effect on the price that could have been offered to shareholders. In essence, the Model Business Corporations Act recognises that a minority shareholder requires additional protection from the market forces as liquidity of the market is restricted and may not be a true reflection of the fair value of the shares.[110]

The Delaware General Corporation Law provides an exception to the market out exception to shareholders of a listed company where in terms of the merger consideration cash is the default consideration receivable by a shareholder[111] or to shareholders of a subsidiary (if not fully owned by the parent company) regardless of the number of record holders or the nature of the merger consideration.[112] The Delaware General Corporation Law' exception to the market out exception is very restrictive as it will not apply in circumstances where the target company shareholders are offered stock-for-stock consideration pursuant to a merger.[113]

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reliance on the market value of shares denied shareholders fair value in some circumstances and rather than a blanket application of the market out exception and included an exemption specifically for interested transactions.

[110] J Yeats op cit note 7 at 55. See also BM Wertheimer op cit note 104 at 638 also highlights that there is an asymmetry of information between the insiders that are proposing the transaction and the shareholders of the company in that the insiders will have access to more information which is not reflected in the market price of the shares. The insiders would accordingly have an unfair advantage and may use this information for their own benefit in setting the offer price of the shares.

[111] Section 262(b)(2) of the Delaware General Corporation Law. In *Krieger v. Wesco Financial Corporation,* 2011 WL 4916910 (Del. Ch. Oct. 13, 2011) the Delaware Court of Chancery considered whether a cash/stock election merger triggered appraisal rights under Delaware law. The Court concluded that no appraisal rights were triggered where the merger agreement provided stockholders of a public target corporation with the uncapped right to elect consideration in the form of publicly listed securities, even though stockholders who did not make an election would receive cash in the merger by default.

[112] Section 262(b)(3) of the Delaware General Corporation Law .

[113] Myers and Korsmo 'Reforming' op cit note 176 at 332-33 argue that the distinction between whether stock or cash is being paid as consideration is misunderstands the purpose of appraisal rights because stock can also be undervalued and exempting these transactions from appraisal rights deprives them of the beneficial governance effects of appraisal rights.

Although the Companies Act has incorporated several trigger events that give rise to the appraisal remedy, which are similar to the Model Business Corporation Act, the Companies Act does not make a distinction between whether a dissenting shareholder's shares are listed on a stock exchange or if they are privately held. The provisions of s164 of the Companies Act give listed and unlisted dissenting shareholders the ability, to force the company to buy-back their shares at their fair value, and for cash, without seeking out a willing buyer and to settle on the price offered by such willing buyer. This exclusion of a market out exception in the Companies Act may be considered to be an indication that the legislatures acknowledge that liquidity and the market price of a share is not a true reflection of the fair value of a company's shares.

3.4. Appraisal rights procedure in terms of the Model Business Corporations Act and the Delaware General Corporation Law

The Model Business Corporations Act and Delaware General Corporation Law have a different procedure for the enforcement of appraisal rights, each with some procedures which are similar to South Africa. Both statutes require that notice be provided to shareholders and that a copy of the appraisal rights available to shareholders be attached to such notice.[114] A dissenting shareholder is required to vote against the relevant resolution approving the transaction[115] and must submit a written demand for appraisal for the number of shares held by such shareholder.[116] From the time that a shareholder makes a demand, such shareholder ceases to be entitled to vote such shares for any purpose or to receive payment of dividends or other

[114] Section 13.20 of the Model Business Corporations Act and section 262(d)(1) of the Delaware General Corporation Law.

[115] Section 13.21(a)(2) as read with section 13.22(b)(1) of the Model Business Corporations Act requires that the dissenting shareholder certify that beneficial ownership of the dissenting shareholder's shares was acquired before the record date of determining shareholders that may vote on the transaction, and requires the dissenting shareholder to certify that such shareholder did not vote for or consent to the transaction.In terms of section 262(a) of the Delaware General Corporation Law , the shareholder must not have voted in favour of the merger or consolidation nor consented to the merger or consolidation. In the case of *Transkaryotic Therapies Inc.,* No. C.A. 1554-CC, 2007 WL 1378345, (Del. Ch. May 2, 2007) which dealt with the question of determining if shares held by a nominee registered shareholder had voted against the relevant resolution for purposes of the beneficial shareholders to exercise appraisal rights, the court held that the beneficial shareholders could enforce their appraisal rights as long as it could be shown that the registered shareholder had voted against the same number or less than the total number of shares that had voted against the resolution approving the transaction.

[116] Section 13.21(a)(1) of the Model Business Corporations Act; Section 262(d) Delaware General Corporation Law . The Delaware General Corporation Law requires that the demand reasonably inform the corporation of the shareholder's identity, number of shares held and indicates the shareholder's intention to exercise their appraisal right and further states that a shareholder cannot rely on a proxy or vote against the merger or consolidation to act as a demand and should submit such written demand separate to his or her vote.

distributions made in respect of the shares. The company is required to advise the dissenting shareholders within 10 days of the approved transaction becoming effective.[117]

The material differences between the procedure set out in the Model Business Corporations Act and the Delaware General Corporation Law relate to the when payment for the value of the shares can be paid. The Model Business Corporations Act, unlike the Delaware General Corporation Law, makes provision for the company to make an offer and to pay the dissenting shareholder the offer value of the shares prior to the commencement of the judicial process of appraisal in respect of any disputed additional amount.[118] The 2016 amendments to the Delaware General Corporation Law provide a company with the option to make a cash payment of any value to a dissenting shareholder prior to the appraisal, which cash payment does not have to be considered to be the fair value of the shares.[119]

In terms of the Model Business Corporations Act, if a stipulated period elapses and a shareholder has not demanded further payment in addition to the amount that was prepaid to the dissenting shareholder, the shareholder will be deemed to have accepted the prepaid amount. Judicial proceedings can only be instituted if the dissenting shareholder makes a demand for appraisal of the disputed further payment of the value of the shares. Thereafter the company is required to file a petition with the court or become liable to pay the disputed further payment to each dissenting shareholder. There is no presumption of acceptance of the prepaid amount in terms of the Delaware General Corporation Law, as the purpose of this provision is merely so as to reduce the amount on which interest accrues.

If a dissenting shareholder that has not withdrawn his/her demand for appraisal, the dissenting shareholder or the company can file a petition in court in order for the judicial proceedings to commence.[120] The only action that is required of a dissenting shareholder[121] prior to court

[117] The Model Business Corporations Act requires that the notice be accompanied by a form which discloses the company's estimated fair value for the shares and the shareholder is required to complete and return to the company before a stipulated date. The Delaware does not have a similar provision.

[118] Section 13.24(a) of the Model Business Corporation Act states: Except where shares were purchased after the record date for the vote on the transaction, within 30 days after the form required by section 13.22(b)(2)(ii) (a statement of the company's estimated fair value) is due, the company shall pay in cash, to compliant dissenting shareholders, the amount the company estimates to be the fair value of their shares, plus interest.

[119] Section 262(h) of the Delaware General Corporation Law.

[120] The petition demanding a determination of the value of the shares of all such shareholders must be filed with the Court of Chancery within 120 days of the transaction becoming effective.

[121] This includes a person who is the beneficial owner of shares held by another party such as, a nominee, on behalf of such person.

proceedings in terms of the Delaware General Corporation Law is that the dissenting shareholder must request the company to provide such dissenting shareholder with a statement setting out the aggregate number of shares that voted against the transaction and with respect to which demands for appraisal have been received and the aggregate number of holders of such shares. Both statutes require that all the dissenting shareholders be joined as parties in one judicial proceeding.

With regard to the guidance in respect of determining fair value, the Model Business Corporations Act entitles a dissenting shareholder joined as a party to the proceedings to judgment:

> '(i) for the amount, if any, by which the court finds the fair value of the shareholder's shares, plus interest, exceeds the amount paid by the corporation to the shareholder for such shares or (ii) for the fair value, plus interest, of the shareholder's shares for which the corporation elected to withhold payment under section 13.25.'

The Model Business Corporations Act provides that "fair value" should be determined as the value of the shares:

> 'immediately before the effectuation of the corporate action to which the shareholder objects; using customary and current valuation concepts and techniques generally employed for similar businesses in the context of the transaction requiring appraisal; and without discounting for lack of marketability or minority status except, if appropriate, for amendments to the company's memorandum of incorporation.'[122]

Should the court determine that the fair value of the shares is less than the amount that was prepaid to the dissenting shareholder, the shareholder will not be required to pay the additional amount received to the company. However, should the court determine that the fair value is higher than the amount that was prepaid by the company, the company will be required to make payment of such additional value for the shares.

The provisions that pertain to how the court must determine fair value in terms of the Delaware General Corporation Law empower the court to determine the fair value of the shares:

[122] Section 13.1 of the Model Business Corporations Act.

> 'exclusive of any element of value arising from the accomplishment or expectation of the transaction, together with interest, if any, to be paid upon the amount determined to be the fair value. In determining such fair value, the Court shall take into account all relevant factors.'

The court's determination of fair value includes any interest accrued, and the Delaware General Corporation Law states how this interest must be calculated, save where the court, in its discretion, decides to rely on a different method to calculate the interest.[123]

With regard to the allocation of the costs, the Model Business Corporations Act provides for various methods of allocating costs and expenses. The Model Business Corporations Act recommends the assessment of the costs for the proceeding, including the reasonable compensation and expenses of appraisers appointed by the court generally against the corporation, except where the court finds that all or some of the dissenting shareholders acted arbitrarily, vexatiously, or not in good faith with respect to the enforcement of their rights.[124] The Delaware General Corporation Law provides that 'the costs of the proceeding may be determined by the Court and taxed upon the parties as the Court deems equitable in the circumstances.' The dissenting shareholder can apply to the court for an order to allocate all or a portion of the expenses incurred by any shareholder in connection with the appraisal proceeding to be charged *pro rata* against the value of all the shares entitled to an appraisal.[125]

Compared to the South African Companies Act, the provisions with regard to how the court must adjudicate the matters of appraisal are fairly similar to both statutes, particularly the provisions that pertain to the court determining a fair value in respect of the shares of all dissenting shareholders and the fair value in respect of any shares being determined as at the date on which, and time immediately before, the company adopted the resolution that gave rise to the shareholder's appraisal rights are fairly similar to those of the Model Business Corporations Act and the Delaware General Corporation Law.

Procedurally the Companies Act does differ in certain aspects with the Model Business Corporations Act and the Delaware General Corporation Law, particularly with regard to the

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[123] Section 262(h) of the Delaware General Corporation Law. Unless the Court in its discretion determines otherwise for good cause shown, interest from the effective date of the transaction through the date of payment of the judgment shall be compounded quarterly and shall accrue at 5% over the Federal Reserve discount rate (including any surcharge) as established from time to time during the period between the effective date of the merger and the date of payment of the judgment.

[124] Section 13.31 of the Model Business Corporations Act.

[125] The set-off against the value of all the shares entitled to an appraisal is subject to the attorney's fees and the fees and expenses of experts being reasonable.

company being required to make an offer to the dissenting shareholder and the timing of payment of the fair value of the shares to the dissenting shareholders. The Companies Act does not make provision for early payment of the uncontested value as is recommended by the Model Business Corporations Act nor does it provide the company with the option to make a prepayment of any cash value as is provided for in the Delaware General Corporation Law.

For purposes of compensating a dissenting shareholder for the time that they have to wait in order to have the fair value determined by the courts, the Model Business Corporations Act and the Delaware General Corporation Law make provision for a dissenting shareholder to be paid the interest that accrues in respect of those shares. However, the wording in the Companies Act provide the court with a discretion to determine 'a reasonable rate of interest on the amount payable to each dissenting shareholder from the date the Companies Action approved by the resolution is effective, until the date of payment'.[126] The Companies Act and the United States statutes do all contain a provision that at the court's discretion the costs for the proceedings can be allocated to the dissenting shareholder.

3.5. Determination of 'fair value' in the Delaware jurisdiction

The determination of fair value is a judicial exercise and the jurisprudence of the state of Delaware has played a significant role in shaping the manner in which fair value is determined by the courts. The valuation methods that have been developed in the Delaware courts include the Discounted Cash Flows method,[127] the Comparable Companies method,[128] Comparable Transactions method,[129] the Net Asset Value method, and the Market Value method.[130] The

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[126] Section 164(15)(c)(iii)(bb) of the Companies Act. The Model Business Corporations Act and the Delaware General Corporation Law bestow a right upon a dissenting shareholder to receive the interest accrued in respect of the value of the shares and the Delaware Court of Chancery can only make an order against receipt of such interest if the dissenting shareholder has acted in a manner that is arbitrary, vexatious, or not in good faith. This is contrary to the South African Companies Act which makes the payment of interest part of the court's discretion.

[127] *Union Ill. 1995 Inv. Ltd. P'ship v. Union Financial Group, Ltd.,* 847_A.2d_340, 359-61 (Del.Ch.2004); *In re Appraisal of Dell Inc.*, C.A. No. 9322-VCL (Del. Ch. May 31, 2016); *Weinberger v UOP* 457 A.2d 701 Del (1983).

[128] *Dobler v. Montgomery Cellular Holding Co.,* 2004 WL 2271592, at *11 (Del.Ch. Sept. 30, 2004).

[129] *In re United States Cellular Operating Co.,* 2005 WL 43994, at *17 (Del.Ch. Jan. 6, 2005).

[130] *Huff Fund Investment Partnership d/b/a Musashi II Ltd. v. CKx, Inc*., Case No. 6844-VCG (Del Ch. Nov. 1, 2013). The Market Value method focuses on the market price where there is an active market and where there are no special circumstances surrounding the case that may affect the market price. On appeal in the Delaware Supreme Court upheld the ruling by the Delaware Court of Chancery in *Huff Fund Investment Partnership v. CKx, Inc*., No. 384, 2014 (Del. Feb. 12, 2015). The company in this matter received an offer of $5.50 per share from one bidder and an offer of $5.60 from another company. However, the company accepted the offer of $5.50 because the company that made the higher offer failed to provide the documents necessary to substantiate

Delaware courts also created what was considered to be the Delaware Block Method.[131] However, there are still debates regarding how fair value should be determined. Goetz[132] states that:

> 'The principal problem is that valuing a company is an inherently speculative process, based upon estimates of the company's future earnings and cost of capital. When modified, these estimates can greatly change the company's projected value. Consequently, the range of values a court may accept in an appraisal proceeding for the value of dissenting shareholders' stock may vary considerably.'

In the case of *Weinberger v UOP*[133] the Supreme Court of Delaware held that there should not be use of one particular valuation method (the Delaware Block Method) and other financial methods of valuation should be considered by the courts and the court can take into consideration 'the future value, including the nature of the enterprise, which are known or susceptible of proof as of the date of the merger'. To ensure that the element of speculation is removed, the methodologies should be substantiated by proof.

In Delaware cases the parties to the appraisal litigation submit evidence from expert valuers which the court analyses and in some instances proposes an alternative valuation method.[134] Unfortunately, evidence provided by expert valuers can range from below the offer price to being significantly above the offer price. Hillis[135] cautions that the expert testimony from valuers appointed by the parties is prone to impartiality and produce vastly different values even where the same valuation method is applied. The Delaware Supreme Court has also cautioned against the Court of Chancery that when faced with evidence provided by expert valuers:

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that it had the necessary funding. When the merger closed, dissenting shareholder exercised their appraisal rights. The court in determining the fair value of the shares considered other valuation methods but it found the DFC analysis, comparable company analysis and the comparable transaction calculations to be unreliable. The court held that in the absence of evidence to the contrary, the price that was negotiated in an arms-length process was the indicator of the fair value.

[131] *Paskill Corp. v. Alcoma Corp.*, 747 A.2d 549, 555 (Del. 2000) wherein the Delaware Supreme Court stated that 'The Delaware Block Method actually is a combination of three generally accepted methods for valuation: the asset approach, the market approach, and the earnings approach. Under the Delaware Block Method, the asset, market and earnings approach are each used separately to calculate a value for the entire corporation. A percentage weight is then assigned those three valuations on the basis of each approach's significance to the nature of the subject corporation's business. The appraised value of the corporation is then determined by the weighted average of the three valuations.'

[132] J Goetz op cit note 101 at 784.

[133] *Weinberger v UOP supra* note 97 at 712 - 713.

[134] *Cavalier Oil Corp v Harnett* 564 A.2d 1137 (Del. 1989).

[135] K Ross op cit note 11 at 48-49. See also: Wertheimer op cit note 104 at 701.

> 'the Court of Chancery must exercise its considerable discretion while also explaining, with reference to the economic facts before it and corporate finance principles, why it is according a certain weight to a certain indicator of value. In some cases, it may be that a single valuation metric is the most reliable evidence of fair value and that giving weight to another factor will do nothing but distort that best estimate. In other cases, it may be necessary to consider two or more factors.'[136]

Therefore the Delaware Court of Chancery usually makes its own determination of the fair value based on its own findings and calculations.

Historically the offer (merger) price of shares has been relied upon by the courts. The courts gave consideration to whether the price had been negotiated by the parties (absent of any conflict of interest) and the Delaware Supreme Court, in several cases has, held that where all other methods of valuation proved to be unreliable or inappropriate for purposes of determining the fair value of shares, the court could rely on the offer price as an indication of the fair value of the shares.[137] The Delaware courts had in several cases[138] been requested to adopt a standard presumption that fair value was the offer price but in all cases the Delaware courts have rejected this limitation of their discretionary powers and have relied on the provisions of the Delaware General Corporation Law that require the court to consider 'all relevant factors' when determining the fair value of shares of a company. This approach by the Delaware courts acknowledges that in some circumstances the offer price cannot be relied upon as indicative of the fair value because each case has different facts. Further, such a determination would leave

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[136] *DFC Global Corporation v. Muirfield Value Partners, L.P., et al.*, C.A. No. 10107 (Del. Aug. 1, 2017) at 84.

[137] *Huff Fund Investment Partnership v. CKx, Inc.,* (2015). Following the Delaware Supreme Court's ruling in *Huff Fund Investment*, the Delaware Court of Chancery started making findings that other valuation methods put forward by the parties' experts to value appraisal shares, in most cases the DCF method, were flawed or contained uncertainties. For example, in *Merlin Partners and AAMAF, LP v. AutoInfo, Inc.,* C.A. No. 8509-VCN (Del. Ch. Apr. 30, 2015), *LongPath Capital, LLC v. Ramtron Int'l Corp.,* C.A. No. 8094-VCP (Del. Ch. June 30, 2015) and *Merion Capital LP v. BMC Software, Inc.* C.A. No. 8900-VCG (Del. Ch. Oct. 21, 2015). In these cases the court also utilised the merger consideration in determining the fair value of the appraisal shares. In each of these cases, the court placed reliance upon the merger price in light of the evidence regarding the process that the companies had undertaken to arrive at the merger price. In *In re Appraisal of Ancestry.com, Inc.* No. 8173–VCG (Del. Ch. Jan 5, 2015) the court gave considerable weight to the merger consideration, even though it found no issue with the DCF method, based on its view that the sale process was 'reasonable, wide-ranging and produced a motivated buyer.'

[138] *Global GT LP and Global GT Ltd v. Golden Telecom, Inc.*, 993 A.2d 497 (Del. Ch. 2010); *Global GT LP and Global GT Ltd v. Golden Telecom, Inc.*, 11 A.3d 214 (Del. 2010); *DFC Global Corporation v. Muirfield Value Partners, L.P., et al.*, *supra* note 106; *Dell, Inc. v. Magnetar Glob. Event Driven Master Fund Ltd.*, No. 565, 2016 (Del. Dec. 14, 2017).

no room for appraisal rights to be of assistance as this approach would mean that dissenting shareholders should just accept the offer price instead of pursuing appraisal rights.

With regard to the question of adopting the offer price as the fair value of shares, the Delaware Supreme Court held in the case of *Golden Telecoms*[139] that:

> 'Section 262(h) unambiguously calls upon the Court of Chancery to perform an independent evaluation of "fair value" at the time of a transaction. It vests the Chancellor and Vice Chancellors with significant discretion to consider "all relevant factors" and determine the going concern value of the underlying company. Requiring the Court of Chancery to defer—conclusively or presumptively—to the merger price, even in the face of a pristine, unchallenged transactional process, would contravene the unambiguous language of the statute and the reasoned holdings of our precedent. It would inappropriately shift the responsibility to determine "fair value" from the court to the private parties. Also, while it is difficult for the Chancellor and Vice Chancellors to assess wildly divergent expert opinions regarding value, inflexible rules governing appraisal provide little additional benefit in determining "fair value" because of the already high costs of appraisal actions.'

The Delaware Court of Chancery, as a result of its discretionary powers, sometimes deviated from utilising the offer price in certain cases. For example, one of the most noteworthy decisions of the Delaware Court of Chancery that rejected the use of the merger price as evidence of fair value is *In re Appraisal of Dell Inc.*[140] The *Dell* case, pertained to a take-private transaction wherein Michael Dell, the founder and owner of 15.7 per cent of the company, entered into an agreement with Silver Lake, a private equity company in 2013. During the sales process competing bids from Carl Icahn and The Blackstone Group were also tendered in respect of Dell which had a resultant effect of increasing the initial offer made by Mr Dell and Silver Lakes to $13.75 per share. However, the Delaware Court of Chancery determined that the fair value of the company was $17.62 per share, an approximate 28 per cent premium to the merger price. This has been cited as one of the reasons there has been an increase in appraisal litigation and appraisal arbitrage in the state of Delaware.

Another case in which the Delaware Court of Chancery issued a ruling that was at or above the offer consideration is in *In re Appraisal of DFC Global Corp.*,[141] in which the dissenting

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[139] *Golden Telecom* (Delaware Supreme Court) supra note 108 at 217-18.

[140] *In re Appraisal of Dell* (2016) supra note 97. The Delaware Court of Chancery held that the negotiation process that was conducted by the company's board prior to signing with the offerors did not seek to obtain the best price, but merely negotiated to get the best price for the company and this undervalued the company as a going concern. The court instead relied on the DCF analysis which considered future projections of the company.

[141] C.A. No. 10107-CB (Del. Ch. July 8, 2016).

shareholders contested the $9.50 per share that was offered as the merger price. After considering several valuation methods the court held that the fair value of the DFC Global shares was $10.21 per share, a 7.5 per cent premium to the merger price. Astonishingly, in another later case of *In re ISN Software Corp. Appraisal Litigation*[142] the court determined the fair value of the company shares to be a premium of almost 158 per cent compared to the merger consideration that was paid by the offeror by adjusting the discounted cash flow analysis that was submitted as evidence by one of the expert valuers. It is no surprise that the practice of appraisal arbitrage arose and became very common in the state of Delaware. Appraisal arbitrage is the practice of buying shares of companies after a merger transaction has been announced with the sole purpose of enforcing appraisal rights in order to obtain a higher price than the merger price offered.

The issuance of fair valuations which were above the merger price gave rise to appraisal arbitrage and introduced a sophisticated form of activist shareholder, being an appraisal arbitrager.[143] Despite several requests and suggestions from actors in the corporate sphere to amend the Delaware General Corporation Law, the Delaware Commission rejected requests and suggestions to standardise the method of determining fair value. The Delaware Commission has been reiterated that despite the appraisal arbitrage shareholders profiting from the remedy, the actions of appraisal arbitrage shareholders does not fall foul of the law. It can be seen that in the period 2010 to 2016 the number of appraisal cases brought before the Delaware Court of Chancery increased.[144] Majority of these appraisal cases that have been adjudicated on by the Delaware Court of Chancery have involved an appraisal arbitrage shareholder.[145]

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[142] C.A. No. 8388-VCG (Del. Ch. Aug. 11, 2016).

[143] This is discussed in detail later in Chapter 4 of this dissertation.

[144] C Boyd op cit note 82 at 503. Boyd highlights that 'in 2011, the amount of appraisal claims nearly doubled, and by 2013, the percentage of transactions that attracted an appraisal petition tripled from 5% to 15% of all merger transactions' and he attributes the increase in the number of appraisal rights being brought to court in this period to the incentive for hedge funds and activist shareholders as there was growing potential of receiving a significant return on investment with theoretically little risk. He also notes that in the period from 2010 to 2014 the Delaware Court of Chancery determined in seven out of none cases that the fair value was higher than the merger price and awarded in favour of the dissenting shareholder.

[145] *Merion Capital LP v. BMC Software, Inc.*, supra note 107; *In re Appraisal of Ancestry.com, Inc. supra* note 107; *Merion Capital, LP v. 3M Cogent, Inc.*, No. 6247–VCP, 2013 WL 3793896 (Del. Ch. July 8, 2013).

However, following amendments[146] to the Delaware General Corporation Law in August 2016, Schoenfeld[147] states that he has observed that the courts have 'issued a slew of at-or-below merger price appraisal opinions' in recent cases and 'as one would expect when costs are raised and benefits are reduced – the effect has been that fewer deals are being challenged via appraisal.' The cases that are referred to are those of *Merion Capital LP v. Lender Processing Services, Inc.*[148], *In re Appraisal of PetSmart, Inc.*[149], and *In re Appraisal of SWS Group, Inc.*[150] in which the determined fair value of the shares was less than or equal to the negotiated merger price

An example of when the determined fair value was less than the merger price in is when the Delaware Court of Chancery held in *In re Appraisal of SWS Group, Inc.*[151] which pertained to the 2015 acquisition of SWS Group Inc. (SWS) by Hilltop Holdings, Inc., that the fair value of the shares was less than the offer price. The dissenting shareholders argued that SWS was worth a fair value of $9.61 per share, which is a 50 per cent premium compared the $6.92 offer price.

[146] The amendments included the provision that allowed companies that are the subject of an appraisal rights claim to make a pre-payment of a cash amount which would be deducted from the final fair value post litigation. This amendment to section 262(h) was introduced so as to defray the high interest payments that may be due following the appraisal litigation. Section 262(g) of the Delaware General Corporation Law was also amended to apply a minimum amount that can be litigated in respect of appraisal claims relating to publically listed companies. The minimum amount that a dissenting shareholder should hold must be more than 1 percent and the total value of the appraisal dispute must be more than $1 million.

[147] M Schoenfeld 'The high cost of fewer appraisal claims in 2017: Premia down, agency costs up' *Harvard Law Review* available at *http://blogs.law.harvard.edu/corpgov/2017/09/08/the-high-cost-of-fewer-appraisal-claims-in-2017-premia-down-agency-costs-up* accessed 24 March 2017.

[148] No. 9320-VCL (Del. Ch. Dec. 16, 2016). The Delaware Court of Chancery relied on the merger price after considering both the merger price and the financial valuation in its analysis of the fair value of the shares. The court determined the fair value of the shares to be equal to the merger price.

[149] C.A. No. 10782-VCS (Del. Ch. May 26, 2017). The dissenting shareholders contended that the $83 per share that was offered in respect of a merger was below their assessed value of $127.78 per share as determined by their expert valuers. After hearing evidence from both parties, the court determined that the DCF analysis that the expert valuers had utilised was unreliable as an indicator of fair value in that the company's projections were not reliable. Management found the project to not be reliable because the projections were not prepared in the ordinary course of business, but for use in the auction process; the management had no experience in preparing long-term projections; the management itself did not believe that the projections were a true reflection of the company's future performance and there was evidence indicating that management's short term projections were also unreliable. The court held that 'while it is true that private equity firms construct their bids with desired returns in mind, it does not follow that a private equity firm's final offer at the end of a robust and competitive auction cannot ultimately be the best indicator of fair value for the company.' Therefore the court placed more weight on the fact that the company had undergone a rigorous sales process prior to accepting the offer. The court ruled that the acquirer had paid the fair value of the shares.

[150] C.A. No. 10554-VCG (Del. Ch. 2017). The SWS Group Inc. was in financial distress and was acquired by one of its major creditors. The Delaware Court of Chancery determined that the fair value of SWS to be 8% below the merger price.

[151] Supra.

The Delaware Court of Chancery determined a fair value of $6.38 for the SWS shares. The Delaware Court of Chancery's deviation from looking at the merger price was as a result of the fact that neither party had relied on the merger price as the fair value and also because the negotiation process of the merger was considered to be unreliable. The court undertook its own DCF analysis and it determined that the fair value of the shares was less than the merger price. It should be noted that one of the dissenting shareholder was a well-known appraisal arbitrager and had bought their shares as part of its arbitrage strategy.

In later cases such as the Delaware Supreme Court case of *DFC Global Corporation v. Muirfield Value Partners, L.P., et al.,*[152] and *Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd*[153] the Delaware Supreme Court issued rulings which were below the offer price. In the *DFC Global* appeal case, the Supreme Court reversed and remanded the Delaware Court of Chancery's decision and held that the Delaware Court of Chancery should have referred to and given weight to the merger price in an appraisal action where the sale of a public company was concluded pursuant to an open, competitive, and arm's-length bidding process. In the *Dell* appeal case the Delaware Supreme Court repeated most of the principles that set out in the DFC Global appeal case and reversed and remanded the decision of the Delaware Court of Chancery on the premise that the basis upon which the court had relied on to disregard the merger price was flawed.[154]

The judicial ruling in the case of *Verition Partners Master Fund Ltd. v. Aruba Networks, Inc.*[155]. in 2018, can be argued to have made appraisal arbitrage more unattractive in that the Delaware Court of Chancery held that the fair value of the appraisal shares was $17.13 which was approximately 30 per cent less than the merger price of $24.67 per shares which Hewlett-Packard Company had paid for Aruba's shares. The court noted that in coming to this conclusion it had heavily relied on the rulings by the Delaware Supreme Court in the *Dell* and *DFC Global* cases and stated that 'DFC and Dell reflect authoritative statements of appraisal law.'[156] The Aruba judgement is considered to have put a damper on the investment strategy

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[152] *DFC Global* supra note 106.

[153] *Dell, Inc. v. Magnetar Global Event Driven Master Fund Ltd* supra note 108.

[154] Supra at 1.

[155] C.A. No. 11448-VCL (Del. Ch. May 21, 2018). The Delaware Court of Chancery concluded that the fair value of the shares was the market price and calculated the determined value by utilising the 30 day average price of the Aruba shares in the market.

[156] Supra at 50. CF Korsmo & M Myers 'The flawed corporate finance of Dell and DFC Global' (2018) 68 *Emory Law Journal* 221-282 at 266 argue that the approach of the Supreme Court in *Dell* and *DFC Global* was a deviation from Delaware' jurisprudence in that it contradicted the Supreme Court's ruling in *Air Products and*

of appraisal arbitragers and hedge funds. The Delaware Court of Chancery took an approach which was rarely utilised when it determined that the fair value of the shares was not the merger value but the value of the shares prior to the date of announcement of the transaction.

The South African courts have not yet determined the fair value of shares in the context of appraisal rights and it is likely that reference will be made to the above Delaware cases when a case is brought before the South African courts. The courts should however remember that section 164 of the South African Companies Act is not specifically aligned with either the Model Business Corporations Act or the Delaware General Corporation Law and is a hybrid of the two statutes, which means that the South African courts should take this into consideration when referring to the United States for guidance. However, this should not limit the South African courts as the Delaware courts have developed several methods for determination of fair value which would be useful in the South African context and would not restrict the courts as each method is applied as and when it is applicable to the case before the courts and does not create hard and fast methods of determination of fair value.

The South African Companies Act differs from the Model Business Corporations Act and the Delaware General Corporation Law with regard to the court's discretion to appoint one or more appraisers to assist it in determining the fair value in respect of the shares. The Delaware courts are considered to be legally sophisticated and to have experience in commercial adjudication and considering that these courts have grappled with the manner in which to determine fair value it may be argued that the South African legislatures saw it fit to include such a provision so as to assist the courts as South Africa does not have specialised commercial courts.[157]

3.6. Anti-appraisal mechanisms in the United States

It can be observed in the United States that as a pre-emptive measure against the appraisal remedy, companies have endeavoured to neutralise and limit the exercise of appraisal rights. These measures are similar to those that South Africa has adopted and include the utilisation of company law mechanisms that do not trigger appraisal rights to effect a restructure of the company; engaging with majority shareholders and securing consensus; and conditional proposal of the transaction.

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*Chemicals, Inc. v. Airgas, Inc.*16 A.3d 48 (Del. Ch. 2011) at 111–113 that 'the directors of a Delaware corporation have the prerogative to determine that the market undervalues its stock and to protect its stockholders from offers that do not reflect the long term value of the corporation under its present management plan.'

[157] J Yeats op cit note 7 at 164.

3.6.1. Utilisation of company law mechanisms that do not trigger appraisal rights

Garza Castañeda has suggested that of the reasons why there are few occurrences of appraisal rights litigation is the resultant effect of the restriction of appraisal rights to certain transactions and the utilisation of other transactions that do not give rise to appraisal rights. [158] As previously stated, the Delaware jurisdiction limits appraisal rights to mergers and consolidations. Therefore when a company in such state engages in a transaction where it disposes of all or a substantial number of its assets, such a transaction would not trigger appraisal rights. Also transaction structures such as the triangular merger and the reverse triangular merger method are a good example of alternative transaction structures that have the resultant effect of a merger but does not fall under the requisite triggering merger and consolidation event in the Delaware jurisdiction. These alternative transactions will be discussed below.

A triangular merger occurs when a company creates / utilises a subsidiary to which it transfers some of its shares into. The subsidiary then enters into a merger agreement with the target company wherein it acquires all the shares of the target company in exchange for the shares that it holds in the parent company. A reverse triangular merger occurs when the parent company creates/utilises its wholly owned subsidiary to acquire another company, resulting in that subsidiary company then being absorbed into the target company. In such transactions the shareholders of the surviving parent company are not required to vote on the transaction because they are not direct shareholders of the subsidiary which is party to the transaction.

Delaware shareholders have challenged such transaction structures and have argued that where a transaction has a resultant effect of changing the control of a company, the shareholders of the target company must be provided with appraisal rights. For example, in the case of *City of North Miami Beach Genl. Employees' Retirement Plan v. Dr Pepper Snapple Group, Inc.*[159] the Delaware Court of Chancery adjudicated over a matter where Dr Pepper and a company called Keurig had implemented a merger through a reverse triangular merger and a special cash dividend payment of $103.75 per share to the Dr Pepper shareholders. Pursuant to the

[158] JJ Garza Castañeda op cit note 8 at 815. He states 'The protection purported by dissenters' rights has two major gaps. First, they can only be exercised over a few transactions, which is fair and consistent with corporate control principles. And second, not all, but only a few, of those transactions utilised to drastically restructure a company or fundamentally change a shareholder's right to participation trigger dissenters' rights. In other words, the majority can often utilise a type of transaction that does not carry dissenters' rights to achieve a corporate restructuring that if attempted differently would give a dissenting minority shareholder the opportunity to have his shares purchased.'

[159] C.A. No. 2018-0227-AGB (Del. Ch. June 1, 2018).

transaction the owner of Keurig would be issued with Dr. Pepper shares that would result in him having an 87 per cent shareholding in Dr. Pepper. In terms of this structure Dr. Pepper would be the resulting parent company, with Dr. Pepper's shareholders gaining cash but retaining a 13 per cent shareholding in Dr Pepper, and with Keurig's stockholders gaining a controlling interest in Dr. Pepper. A vote on the merger was not required and the Dr. Pepper shareholders only had to vote on the cash dividend and the issue of the new shares to Keurig.

Certain Dr. Pepper shareholders instituted legal proceedings in which they claimed that as a result of the merger they had appraisal rights in terms of section 262 of the Delaware General Corporation Law, which the company had not offered them in terms of the transaction. The Delaware Court of Chancery ruled that the appraisal rights under section 262 were available only to shareholders of a 'constituent corporation' being an entity actually being merged or combined, and not necessarily to shareholders of the parent company.[160] As such the Dr. Pepper shareholders were not entitled to appraisal rights as a result of the structure. In addition the Delaware Court of Chancery held that section 262 applies to shareholders who have been forced to give up their shares in connection with a proposed merger.[161] Despite the fact that the Dr Pepper shareholders were going to become minority shareholders in the company as a result of the transaction, the Dr. Pepper shareholders were going to retain their shares.

Other anti-appraisal mechanisms that a company can utilise to avoid appraisal rights is through utilising the market out exception by offering publically listed shares as consideration for the merger. Therefore a company could avoid triggering appraisal rights by offering shareholders an option to receive either cash or shares. Another anti-appraisal mechanism whereby a transaction could be structured so that it avoids appraisal rights is where the target company is first reincorporated in another state that does not provide appraisal rights, and then is acquired in a cash merger.[162]

3.6.2. Entering into support agreements with shareholders

In the United States, a company can enter into agreements with certain shareholders in terms of which the shareholders agree to vote in favour of a resolution that pertains to a proposed transaction. Such an agreement in the United States context can further include terms that

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[160] Supra at 2.
[161] Supra at 22.
[162] Section 253 of the Delaware General Corporation Law.

pertain to the waiver of appraisal rights which state that the relevant shareholders will not assert, exercise or perfect their appraisal rights in connection with the proposed transaction.

The Delaware Court of Chancery in the recent case of *Manti Holdings LLC v. Authentix Acquisition Co.*[163] where the plaintiffs argued that the shareholder agreement that they had entered into with the company was invalid because it added a restriction to their shares with regard to exercising their appraisal rights, the court held that shareholders could validly contract out of their right to exercise the appraisal remedy subject to the shareholder having voluntarily signed the shareholder agreement in return for consideration. Such contracts are accordingly enforceable and shareholders would be bound by their contractual obligations in terms of the shareholder agreement. This decision by the Delaware Court of Chancery was not too far-fetched as the court had orbiter dicta inferred that it was possible for shareholders to waive their appraisal rights ex ante in connection with an agreement to vote in favour of a transaction in the earlier case of *Halpin v. Riverstone National, Inc.*[164]. This also agrees with the approach of the Delaware Court of Chancery in *In re Appraisal of Ford Holdings, Inc., Preferred Stock*[165] wherein the court had ruled that preference shareholders could contractually waive their rights to appraisal as a result of their relationship with the company being contractual in nature.

In light of the Delaware Court of Chancery recent ruling in the *Manti Holdings* case, which involved an argument by shareholders party to a shareholder agreement that the enforcement by the company of the clauses that precluded the shareholders was contrary to public policy and contravened the intent and purpose of the Delaware General Corporation Law, wherein the court held that the shareholder contract was not a limitation on their appraisal rights but was

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[163] C.A. No. 2017-0887-SG. The facts of the case were that the company entered into a merger agreement with a third party. The applicants had a shareholder voting and support agreement with the company and following the implementation of the merger, in terms of which they received very little cash consideration in return for their shares, they attempted to exercise their appraisal rights in respects of their shares. The Delaware Court of Chancery held that as a result of the shareholder agreement which barred the shareholders from exercising appraisal rights in the event of the sale of the company in terms of merger, the shareholders could not exercise their appraisal rights against the company.

[164] C.A. No. 9796-VCG (Del. Ch. Feb. 26, 2015). The Delaware Court of Chancery did not make a direct pronunciation on the matter because it was not the subject of the case before it. The court had ruled in favour of the plaintiffs and agreed that the shareholders could exercise their appraisal rights because the company had approved the merger whereas the terms of the contract required that the shareholders, with advance notice, would vote in favour. Technically the shareholders were not bound to not exercise their appraisal rights because the company had not required them to vote in favour of the merger.

[165] 939 A.2d 1281, 1284 (Del.2007).

entered into pursuant to an investment decision.[166] The court gave consideration to the fact that the shareholders had entered into the shareholder agreement in return for consideration which was to the benefit of all parties. The Court held that the shareholder agreement 'did not restrict the appraisal rights of the classes of stock held by the [p]etitioners; instead, the [p]etitioners, by entering the [shareholder agreement], agreed to forbear from exercising that right.'[167] Despite the Companies Act containing the anti-avoidance provisions in section 6, it can be argued that the South African courts could follow the same approach as in the *Manti Holdings*[168] case.

3.6.3. Appraisal rights conditions precedent

As stated in the earlier chapter, the practice of utilising an appraisal condition precedent originated in the United States and has become recognised as a mechanism for reducing the risk of appraisal exercise in a transaction. The condition is referred to as the "kick out", "appraisal out" or "closing" condition and its main function is to allow the acquirer or the target company to walk away from the transaction should a certain number of target shareholders dissent to the transaction and exercise their appraisal rights. The presence of this clause/condition in a transaction agreement serves the purpose of reducing the risk of appraisal rights, especially in the United States, where appraisal rights can be exercised by a dissenting shareholder up until the transaction closes.

Manning[169] notes that:

> 'It is common to find in merger agreements kick-out provisions under which one or both boards may call off the transaction if it appears that an intolerable amount may have to be paid to dissenters. These provisions help. But they do not fully solve the problem. They introduce an extraneous element of contingency into the transaction. They impose a severe bargaining disadvantage where only one of the participating companies thinks that it has a substantial number of potential dissenters: the shareholders and management of the unanimous company are not apt to be happy at seeing their cash siphoned off to shareholders of the other corporation immediately after the merger.'

The inclusion of such a clause in a transaction agreement, although it does protect the acquirer, may, however, have a negative effect on the success of obtaining support for the transaction as it does not provide the target company with sufficient certainty that the transaction will close.

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[166] Supra at 10-11.
[167] Supra at 10-11.
[168] *Manti Holdings* supra note 135.
[169] B Manning op cit note 7 at 614-15

The general thought by practitioners in the United States is that the inclusion of a closing condition may have negative effects on the proposed transaction. Boyd states that 'an appraisal condition can be of consequence to both the seller and the buyer, by providing shareholders with leverage and inviting coercive shareholder behaviour that both sides of the transaction would like to discourage.'[170] Accordingly, the utilisation of this mechanism has fluctuated over the years, and it has been noted that the use of appraisal right conditions has reduced in the United States in contrast to the increase in the number of appraisal rights cases.[171]

3.7. Conclusion

The appraisal rights set out in the Model Business Corporations Act and the Delaware General Corporation Law have existed for many decades and the jurisprudence that has been developed during this time period has been vast. Both statutes were drafted to serve the primary purpose of appraisal rights, which is to provide a dissenting shareholder a remedy to exit from his/her investment in the company.[172] Amendments to both statutes throughout the years indicate that societal requirements and practices have influenced the provisions that the Model Business Corporations Act and the Delaware General Corporation Law have provided to dissenting shareholders in respect of appraisal rights. The development of the application of the market out exception in certain circumstances and the application of an exemption to the market out exception is a perfect example of the progress that both statutes have made. The flexibility of the statutes can also be seen in the last few years where appraisal arbitrage has arisen and the statutes have been amended accordingly.

As can be expected in a federal system that has individual state laws, the Delaware General Corporation Law has incorporated the main principles of the Model Business Corporation Act and through judicial interpretation of the law developed a rich jurisprudence. Notwithstanding that the Delaware General Corporation Law limits the number of trigger events, the Delaware courts has through the adjudication of several cases developed a number of appraisal valuation methodologies and without limiting the discretionary powers of the courts or applying the same

[170] Boyd op cit note 82 at 519-520.
[171] Boone et al op cit note 65 at 24. Boone argues that the reason for the decline in use of the appraisal out clause is that it appears as though target company are not negotiating or demanding huge concessions in order to include such a clause because such clauses has never been triggered. Boone further notes that existing research suggests that appraisal is more likely to occur when the premium of the offer price is below normal.
[172] J Goetz op cit note 101 at 776.

rule to different circumstances the courts have further developed standardised initial approaches to determining the fair value of shares.

As can be seen with the Companies Act in South Africa and other countries such as Canada and New Zealand, the Model Business Corporations Act and the Delaware General Corporation Law act as good templates from which to build corporate law that incorporates the appraisal remedy. The Delaware jurisprudence has highlighted and settled some of the main arguments that were posed against the adoption of the appraisal remedy in the United States and have made the remedy attractive for application in other jurisdictions outside of the United States. Further the practice of shareholder activism and appraisal arbitrage appears to have made the remedy contribute to the development of a consistent approach to appraisal fair valuation and added to the debate and development of Delaware's jurisprudence on appraisal rights.

In both the United States and South Africa, a company has a number of mechanisms at its disposal for purposes of minimising the risk of appraisal rights being exercised in a proposed transaction. These methods, however, cannot take away the availability of the remedy from the dissenting shareholders, unless the shareholder voluntarily contracts out of exercising such rights as a result of a shareholder agreement. In light of having a fiduciary duty to shareholders, the management and directors of a company can only utilise the above risk management mechanisms to a limited extent.

The next chapter will discuss shareholder activism and how it has developed appraisal arbitrage in the United States, which is also considered a deterrent or restraint on bad business judgment by directors. The chapter will discuss how shareholder activism is progressively becoming aligned with appraisal rights in the context of proposed fundamental transactions and how the continued efforts of shareholder activists in this arena may counter the neutralisation of the appraisal right and have the resultant effect of developing the appraisal right jurisprudence in South Africa.

CHAPTER 4: THE DEVELOPMENT OF APPRAISAL ARBITRAGE RIGHTS IN THE UNITED STATES

4.1. Introduction

The term shareholder activism refers to instances where a shareholder utilises his/her partial ownership in a public company to influence the conduct of business by the directors and management of the company. Shareholder activism has become a global trend and it is primarily visible in the United States and in Europe. The advent of shareholder activism is noted to have begun following a number of corporate scandals in the United States, most notably Enron Corporation, in the early 2000s.[173]

The basis for the interference of shareholders in the running of a company is premised on the theory that 'managers are the agents of shareholders (or owners) and in their capacity as agents, are obligated to act in the best financial interest of the shareholders of the corporation.'[174] In essence, the shareholder leverages his/her status as an owner of the company to actively engage in the affairs of the company, ask questions, take action against and or demand action from management and the directorship. Shareholder activism may range between corporate governance activism and financial value activism. The latter form of activism refers to action which increases financial value to the shareholders through focusing on the company's share price performance and market value, financial strategy and involvement in transactions, whereas the former form of activism refers to action that reforms the company's engagement with stakeholders and its behaviour as a corporate citizen.

Shareholder activists manage to influence the company by engaging in private discussions with management, public discussions with the media, participating, asking questions and voting at shareholder meetings, and as a drastic measure call a shareholders meeting, initiate litigation against the company or directors or divest from the company.[175] Essentially a shareholder

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[173] Francis J Aquila *The Shareholder Rights and Activism* Review 3ed (2018) 148-159 at 148 available at *https://thelawreviews.co.uk//digital_assets/ec6e2d3b-27c1-424d-90db-cee6acd2a143/The-Shareholder-Rights-and-Activism-Review-%E2%80%93-3rd-edition.pdf* accessed on 21 November 2017.

[174] G J Rossouw 'Balancing corporate and social interests: Corporate governance theory and practice' 2014 (3) 1 *African Journal of Business Ethics* 28 at 29. In an appraisal context the directors of the target company have fiduciary duties to act in the best interests of the shareholders and to endeavour to maximise the value received by its shareholders in a transaction.

[175] Suzette Viviers 'Individual shareholder activism in South Africa: The case of Theo Botha' 2016 9 (2) *Journal of Economic and Financial Sciences* 347-369 at 348. The type of strategy that an activist shareholder takes depends on the circumstances and the type of shareholder. In corporate transaction scenarios a shareholder

activist has become an investor that actively participates in the activities of a company in which he has an investment and takes a keen interest in ensuring that the company is working towards addressing governance issues or strategy issues. On the far spectrum of financial value activism a shareholder activist can seek to effect change by effectively advocating for the company to sell itself or merge with another company.

For purposes of this research, the shareholder activism that will be considered will be limited to financial value activism, with particular reference to shareholder action that involves fundamental transactions where appraisal rights arise or could have arisen. The appraisal rights remedy has become a tool for shareholder activism in that the mere threat of appraisal right litigation can act as a deterrent to opportunistic and negligent price-setting by the company and on the other hand motivate the company to offer a high price per share to its shareholders from the time of proposal.[176]

Theoretically the appraisal rights remedy protects minority shareholders and creates a balance of power between dissenting minority shareholders and majority shareholders and the company.[177] Myer & Korsmo[178] state that for the appraisal remedy to be effective as a tool for corporate governance it should be used to target transactions that ought to be targeted, which are those that have the greatest risk of minority shareholders being mistreated. This accords with Cassim et al[179] determination that despite historically being considered a method for exiting a company, the modern function of the appraisal right remedy has the effect of *(i)* creating a balance between the majority and the dissenting shareholder, *(ii)* act as a mechanism for a dissenting shareholder that is not satisfied with the price offered by the company (either pursuant to the transaction or in respect to an offer to buy the shares after the appraisal rights

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activist either seeks to stop the transaction from being implemented or they seek to receive the best value for their shares.

[176] CF Korsmo & M Myers 'Appraisal arbitrage and the future of public company M&A' (2015) 92 (6) *Washington University Law Review* 1151 at 1601. See also: M Myers & C R Korsmo 'Reforming modern appraisal litigation' (2017) 41 *Delaware Journal of Corporate Law* 279 at 284.

[177] Cassim op cit note 43 at 138. Cassim et al 'Contemporary Company Law' op cit note 9 at 767.

[178] Myers & Korsmo 'Reforming' op cit note 176 at 62.

[179] Cassim et al 'Contemporary Company Law' op cit note 9 at 797 states that appraisal rights ensure that directors do not negate their duties to act in the best interest of shareholders even when they may receive side-benefits form the other party as part of the transaction. Further as a result of not wanting to increase the number of shareholders that seek appraisal, a company would ensure that it proposes transactions that would appeal to majority, if not all, of its shareholders, thus ensuring that the directors exercise good business judgment in all instances.

have been enforced) to challenge the fairness thereof and, *(iii)* lastly, it acts as a deterrent or a restraint on bad business judgment by directors.[180]

A shareholder activist can be an individual or institutional investor. An individual shareholder would be a natural person as per the definition in the Companies Act, whereas an institutional shareholder would be a juristic person that holds the company's shares in its own name for its own benefit or for the benefit of other persons (natural and/or juristic) such as hedge funds, fund managers, nominee and brokerages. In the United States some individual shareholders, who are affiliated to hedge funds and investment funds such as Carl Icahn, Bill Ackman and Paul Singer have gained notoriety as key shareholder activists who have used the appraisal rights remedy for purposes of influencing the companies in which they were invested, with varying results. These individuals will be discussed in further detail in this chapter.

4.2. Shareholder activism and appraisal arbitrage in the United States

There are several famous shareholder activists in the United States and similarly to South Africa their corporate activism ranges from issues of corporate governance to matters of financial value activism. The most famous of the shareholder activists that are involved in financial value activism are Carl Icahn[181] and Bill Ackman,[182] and influential institutional shareholders are Third Point,[183] Merion Capital,[184] and Verition Partners Master Fund,[185] to name a few. Prior to the emergence of these shareholder activists in the corporate landscape in the United States, the appraisal remedy had not been a major topic of discussion. This rise in the use of the appraisal remedy as a tool for shareholder activism was primarily influenced by

[180] Ibid.

[181] Carl Icahn is notorious for his activism during the Dell buy-out transaction in 2013 and also in opposing Dell's recent proposal to launch an initial public offering, 5 years after it had gone private. In 2013, Dell argued that the proposed transaction by the founder, Michael Dell, in partnership with Silver Lakes Partners undervalued the company and went to the extent of making a competing bid to Dell shareholders. Icahn also attempted to have the directors of the companies removed.

[182] William "Bill" Ackman is an activist investor that is notorious for investing in companies wherein he launches public activist campaigns to gain board representation or control, board reform and strategy reform.

[183] Funds associated to Third Point were petitioners in the case of *PetSmart Inc.* supra note 219.

[184] Merion Capital LP was founded by Andrew Barroway and was a petitioner in several cases in the Delaware jurisdiction which include *Merion Capital LP v. BMC Software, Inc.*, *supra* note 218; *In re Appraisal of Ancestry.com, Inc. supra* note 107, *Merion Capital, LP v. 3M Cogent, Inc.* supra note 115 and *In re Dole Food Company, Inc. Stockholder Litigation, Consolidated* C.A. No. 8703-VCL; *In re Appraisal of Dole Food Company, Inc., Consolidated* C.A. No. 9079-VCL.

[185] Verition Partners Master Fund was the petitioner in the case of *Aruba Networks* supra note 224.

the change in legislation and case law and a reduction in the risks that are associated with pursuing appraisal rights.

4.2.1. Carl Icahn in the Dell transaction

In February 2013 Mr Icahn launched an activist campaign against Dell Computer going-private transaction. He contested the proposed buyout led by Michael Dell, the founder, to take the company private for an aggregate price of $24.4 billion. Mr Icahn, was not a shareholder of Dell until after he began acquiring Dell shares after the transaction agreement was announced. In his activist crusade he was joined by Southeastern Asset Management and other large Dell shareholders. They argued that the price offered in terms of the proposed transaction was too low compared to calculations of what the fair value of the company was. Mr Icahn encouraged shareholders not to vote for the transaction and urged other shareholders to exercise their appraisal rights under the Delaware General Corporation Law. Mr Icahn vocalised his discontent with the proposed transaction in the media and the press and when Mr Dell failed to receive the support to approve the proposed transaction, Mr Dell's team eventually increased the offer price.

In an interesting twist of events, when the transaction was approved in September 2013, Mr Icahn withdrew his appraisal demand. It appears as though Mr Icahn never actually intended to pursue appraisal rights litigation and he merely used the threat of doing leverage for a higher buyout price. This action by Mr Icahn had the effect of benefiting himself and other shareholders in the end. It can be argued that his action also encouraged other shareholders to pursue appraisal rights which resulted in the infamous Dell appraisal case.

4.2.2. Dole Food Company versus dissenting shareholders

In a management buyout of Dole Food Company in 2013 its shareholders were offered $13.50 as a cash consideration for each of their shares, which many shareholders did not think was fair. However, the deal was approved by a narrow majority of 50.9 per cent, and when the going-private transaction was implemented in November 2013, a large number of Dole's shareholders exercised their appraisal rights and other shareholders sued for a breach of fiduciary duty by the chief executive officer and the chairman of the board. Of these dissenting shareholders, four of them were large hedge funds, which were repeat appraisal petitioners in other cases and had purchased shares after the transaction had been announced. The result is that the Delaware Court of Chancery held that Dole had not paid the fair values of the shares

and ruled that the fair value of the shares was $16.24, an additional $2.74 than the offer price.[186] The Court noted that in circumstances where a merger gave rise to both an appraisal proceeding and an action for breach of fiduciary duty, the action dealing with a breach of duty should be dealt with as 'a finding of liability and the resultant remedy could moot the appraisal proceeding.'[187] The Delaware Court of Chancery found the two directors were liable and had been in breach of their duties.

4.2.3. Starz Inc. and Lions Gate versus dissenting shareholders

Starz Inc. (Starz) and Lionsgate Entertainment Corporation (Lions Gate) entered into a merger agreement in terms of which Starz shareholders, of two different classes, where the Starz Series A shares were offered consideration of $18.00 per share in cash and 0.6784 Lions Gate non-voting shares, and the Starz Series B were offered consideration of $7.26 per share in cash, 0.6321 Lions Gate non-voting shares and 0.6321 Lions Gate voting shares, an aggregate total consideration of $4.4 billion. Following the implementation of the transaction in December 2016, seven petitions (which were later consolidated into one case by the Delaware Court of Chancery) were filed against Starz and the former board members.[188] Shareholders of approximately 25 million shares of Starz Series A shares disputed that the consideration offered for their shares was fair made demands for appraisal and argued that the relationship between the parties had negatively affected the transaction and merger price offered to shareholders.[189] Two of the dissenting shareholders withdrew their appraisal rights in 2017 and the remaining amount of shares subject to appraisal reduced to 22.5 million shares.

Prior to the matter being heard in court and following several attempts to settle with the dissenting shareholders, in August 2018, Starz announced that it had settled with the dissenting

[186] *In re Dole Food Company, Inc. Stockholder Litigation, Consolidated* C.A. No. 8703-VCL; *In re Appraisal of Dole Food Company, Inc., Consolidated* C.A. No. 9079-VCL. Shareholders instituted both breach of fiduciary duty litigation and exercised their appraisal rights.
[187] Supra at 56.
[188] The law suit focused on the fact that Starz's controlling shareholder and also a shareholder in Lionsgate, John C. Malone, arranged the merger for his own benefit and at the expense of the Series A shareholders.
Starz had two classes of stock – Series A with one vote per share and Series B with 10 votes per share. Mr. Malone was Starz's controlling shareholder due to his large holdings of Starz Series B stock. He also owned a significant stake in Lionsgate where he was also a board member.
[189] Josh Kosman 'New twist in Paul Singer battle over Lionsgate' New York Post 22 January 2018 available at *https://nypost.com/2018/01/22/paul-singer-gains-upper-hand-in-battle-over-starz-value/* accessed 9 March 2018.

shareholders for an amount of $92.5 million,[190] a considerable higher value than that which was offered in terms of the merger. It must be noted that one of the dissenting shareholders in this matter was Paul Singer, a well-known shareholder activist. This was Paul Singers' first filing of an appraisal action.

4.2.4. Paul Singer – an example of a bumpitrager

Paul Singer, through his investment fund, Elliot Management is more skilled at utilising the threat of appraisal rights in order to facilitate an increase in the offer price. For example, in 2018, he managed to apply sufficient pressure on Qualcomm Inc. for it to increase its bid offer in its takeover of NXP Semiconductors NV. Qualcomm increased its offer to an amount which was $6 billion higher than its original bid, from $110 per share to $127.50 per share; after Elliot Management had complained that the initial offered price was too low.[191] However the transaction was subsequently cancelled after the companies failed to obtain approval for the takeover from the Chinese authorities.

Mr Singer's reputation precedes him, and without actually making a demand for the offer price to be increased in the acquisition of United Kingdom based Poundland Group PLC by South African based Steinhoff International NV, Steinhoff decided to increase the offer price when Elliot Management increased its stake in Poundland to 17.5 per cent.[192] Steinhoff increased its offer price to shareholder from 222 pence per share to 227 pence per share, an aggregate offer of £610 million. Mr Singer's approach to shareholder activism through Elliot Management has been described as event driven shareholder intervention[193] in that he waits for a transaction to be announced before increasing his stake and applying pressure on the company.

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[190] 'Lions Gate to settle Starz investor suit for $92.5 million' available at *https://www.law360.com/articles/1090834/lions-gate-to-settle-starz-investor-suit-for-92-5m* accessed 2 November 2018.

[191] Ronald Orol 'Qualcomm's higher NXP bid secures IK from Elliot Management's Paul Singer' available at *https://www.thestreet.com/story/14493363/1/qualcomm-higher-nxp-bid-secures-ok-from-elliott-singer.html* accessed on 26 October 2018.

[192] Paul Jarvis & Sam Chambers 'Steinhoff raises Poundland offer by 5p a share – enough for Greenmalier? available at *https://www.biznews.com/briefs/2016/08/11/steinhoff-raises-poundland-offer-by-5p-a-share-enough-for-greenmailer* accessed on 22 October 2018.

[193] Gavin Davies and Mark Bardell *The Shareholder Rights and Activism Review* 2ed Francis Aquila (2017) at 139 available at *https://thelawreviews.co.uk//digital_assets/ec6e2d3b-27c1-424d-90db-cee6acd2a143/The-Shareholder-Rights-and-Activism-Review-%E2%80%93-3rd-edition.pdf* accessed on 3 December 2018. Ronald Orol 'Elliot's Paul Singer – The 800 pound gorilla of activism' available at *https://www.thestreet.com/story/14343155/1/elliotts-paul-singer-the-800-pound-gorilla-of-activism.html* accessed 26 October 2018.

Mr Singer is well known for Elliott Management's involvement in the AB InBev/SABMiller takeover. In 2015 AB InBev made an offer to takeover SABMiller for an aggregate amount of £71 billion. Elliot Management took advantage of the fall in the pound sterling following the Brexit results after the value of the cash consideration fell below the value of the share consideration alternative.[194] Elliott Management acquired an interest in SABMiller and put pressure on AB InBev to make a revised offer on better terms. Elliott Management was successful in getting AB InBev to increase the cash consideration from 4 400 pence per share to 4 500 pence per share, an aggregate value of SABMiller at £79 billion.

4.3. Appraisal rights as an unconventional tool for shareholder activism

The primary purpose of shareholder activism is to hold directors to account and to foster transparency in the company's activities as well as ensuring that the company's actions are to the benefit of all stakeholders (shareholders, employees, communities, etc). Appraisal rights are likely to be exercised where there is a perceived conflict of interest, going private transactions, minority shareholder buy-outs and low offer price.[195] Wertheimer notes that the appraisal remedy fulfils a function before the transaction of deterring management and insiders from engaging in wrongful transactions, and after the transaction, the remedy provides a remedy to minority shareholders.[196]

In this regard, for purposes of mitigating the threat of appraisal rights being exercised the company will need to conduct its negotiations in a manner that will not be questionable and propose a transaction that is appealing to shareholders. As a result of appraisal shareholder activists' focus on conflict-of-interest transactions, shareholder buyouts without a negotiated process or controlling shareholder squeeze outs, appraisal rights may be considered as 'a monitoring mechanism that polices low premiums and conflict-of-interest transactions far better than the much-maligned shareholder fiduciary duty class action.'[197] Accordingly, if the

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[194]Ibid at 140.

[195] Wei Jiang, Tao Li, Danqing Mei & Randall Thomas 'Appraisal: shareholder remedy or litigation arbitrage?' (2016) 59 (3) *Journal of Law and Economics* 697-729 at 699.

[196] BM Wertheimer op cit note 104 at 616.

[197] Jiang et al op cit note 195 at 702 notes that 'in fact, one Delaware judge stated that "strong arguments can be made that appraisal represents a more rational and efficient alternative to traditional fiduciary duty litigation"' while referring to the case of *In re Appraisal of Dell Inc*. See also: Abigail Pickering Bomba, Steven Epstein, Arthur Fleischer, Jr., Peter S. Golden, Philip Richter, Robert C. Schwenkel, David N. Shine, John E. Sorkin, Gail Weinstein 'New activist weapon: the rise of Delaware appraisal arbitrage: a survey of cases and some practical implications, Fried Frank (2014) 2 available at *https://www.friedfrank.com/siteFiles/Publications/FINAL%20-%206182014%20TOC%20Memo%20-%20New%20Activist%20Weapon--%20The%20Rise%20of%20Delaware%20Appraisal%20Arbitrage.pdf*

company is transparent and discloses how the offer price was negotiated and determined, the chances of a shareholder contesting the offer price by means of appraisal rights are severely reduced.

It is generally considered that the protections and remedies that are set out in the Companies Act bestow a power on shareholders, particularly minority shareholders, which can be used for purposes of shareholder activism if such power is harnessed. The appraisal remedy, unlike other remedies that are provided to shareholders, such as the derivative action (which is corrective in nature), has the effect of removing the dissenting / activist shareholder from the company and thus divesting the shareholder from having any future influence on the company. The nature of the remedy limits the use of the remedy as a tool to effect change in the company and is to some extent a last resort measure on the part of a shareholder. It must be pointed out that the appraisal remedy does not stop the company and the majority shareholders from proceeding with the transaction that the dissenting shareholder objected to in the first place. Also it should be remembered that appraisal rights are not an easy remedy to pursue and the litigation may take years to be finalised, all the dissenting shareholders have to pay their own fees and take on the risk of a court may determine a fair value that is less than the offer price.

Another aspect of the remedy that limits appraisal rights as a tool for shareholder activism is that in a situation that a dissenting shareholder is successful in obtaining a judicially determined higher fair value for his or her shares, the remedy does not work retrospectively or to the benefit of the other shareholders that have accepted the company's transaction offered price. The remedy works to the benefit of the individual dissenting shareholder or those that have dissented.[198] Only the dissenting shareholders that have complied with the appraisal rights procedural requirements at the time of application to the court are required to be joined to court

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accessed on 16 May 2018, note that 'while the only consideration in an appraisal proceeding is the determination of fair value (and wrongdoing by the target board or flaws in the sale process are legally irrelevant for these purposes), the transactions that attract appraisal petitions generally involve some basis for a belief that the deal price significantly undervalues the company — that is, controlling stockholder transactions, management buyouts, or other transactions for which there did not appear to be a meaningful market check or significant minority shareholder protections as part of the sale process.'

[198] Wei Jiang, Tao Li, Danqing Mei & Randall Thomas 'Reforming the Delaware Appraisal Statute to Address Appraisal Arbitrage: Will it be Successful?' (2016) at 11 available at *https://pdfs.semanticscholar.org/a9c7/645387a4857c9d1efd39ed281fe50e188d84.pdf* accessed on 14 March 2018.

proceedings for the purpose of valuing their shares.[199] The remedy has a very individualistic approach to assisting shareholders.

It has been argued that the appraisal remedy is only useful to shareholders that hold a large number of shares in a company and proves to be of little assistance to minority shareholders.[200] In many of the South African cases discussed in this chapter, the individual shareholder activists that were mentioned did not hold a substantial number of shares in the companies that they took activist action against. Further, for some of the institutional shareholders the cost:benefit ratio of exercising appraisal right may result in more costs for their underlying shareholders than they would wish to incur. In the United States, prior to the inclusion of the *de minimis* rule to the Delaware General Corporation Law, although most dissenters held a considerable number of shares, there were some shareholders that held a small number of shares that exercised appraisal rights.[201]

4.4. Appraisal Arbitrage as a form of shareholder activism

As previously stated there are individual and institutional shareholders that have become active in the exercise of appraisal rights in the United States, however, particularly in the state of Delaware activist hedge funds are a common feature and have utilised the appraisal remedy for a practice referred to as 'appraisal arbitrage'. Appraisal arbitrage began to occur on a large scale after 2007 and the primary participants were specialised entities in the form of hedge funds.[202] The primary purpose of a hedge fund is to make a profit through investing their

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[199] Each individual shareholder is required in their own capacity to follow the procedural requirements in order to enforce their appraisal rights. The statutes that govern appraisal rights do not make provision for dissenting shareholders that have not complied with the procedural requirements to join proceedings. If a shareholder fails to comply with the procedural requirements his/her right to appraisal lapses.

[200] Siegel (2011) op cit note 7 at 311.

[201] Jiang et al op cit note 195 at 708, identified that during the period 200-2014, 32 per cent of the appraisal cases that were filed, the shareholders had a collective holding of less than $1 million and represented less than 1 per cent of the total shares of the company. This is identified as one of the reasons that the Delaware General Corporation Law 2015 amendments introduced a *de minimis* requirement that shareholders seeking appraisal would have to collectively hold at least one percent of total shares outstanding or one million dollars' worth of shares. This amendment was introduced so as to reduce the number of nuisance claims for appraisal on shares that were less than the cost to litigate the matter.

[202] Bomba et al op cit note 197. See also Hamermesh, Lawrence A. and Wachter, Michael L., 'Finding the right balance in appraisal litigation: deal price, deal process, and synergies' (2018) available at *University of Pennsylvania Law School Penn Law: Legal Scholarship Repository* 4 available at *http://scholarship.law.upenn.edu/faculty_scholarship/1954* accessed on 9 October 2018. See also Jiang et al op cit note 195 at 706 wherein an empirical study shows that during the years 2000-2014 Merion Capital, Magenetar Capital, Merlin Partners, Anroca and Qudre Investments were the main participants in appraisal litigation and they filed 61 cases which were 27.1 percent of all the cases filed in that period.

money in companies and one such method of investment was through buying shares in a company that had made a merger announcement and exercising appraisal rights in respect of such shares so as to receive a return from the courts' determination of fair value. Essentially appraisal arbitragers are shareholders who manage to utilise the appraisal remedy for investment purposes and to use the remedy to procure profits for their own benefit.

Jetley & Ji[203] attribute the development of appraisal arbitrage, firstly, to the decision in *Transkaryotic Therapies*[204] which allowed for hedge funds to obtain standing following the purchase of shares after the transaction announcement or after it has been approved to exercise appraisal rights, secondly, the potential of a better valuation method being applied by the court which is better than the calculated rate used by investment bankers and other deal advisers, thus increasing values calculated in appraisal proceedings compared to prices negotiated in the real world of business, and, lastly, the award of interest at the Delaware legal rate of 5 per cent over the Federal Reserve Bank's interest rate which rate is significantly higher than the rate receivable in other investments.[205] Appraisal arbitrage was found to have a higher chance to occur in transactions that involved a conflict of interest (i.e. management buy-out) and where the offer price had a low premium.[206]

Appraisal arbitrage is a controversial subject. There is a debate regarding whether appraisal arbitrage is moral and equitable.[207] Boyd states that 'the words that come to mind when attempting to define "arbitrage" inevitably include terms such as lies, trickery, unfair play, and deception.'[208] It is considered as buying of a lawsuit in that the arbitragers buy the shares for the specific purpose of exercising appraisal rights. The perception of appraisal arbitragers is that they are taking advantage of the system and are utilising a remedy that is meant to protect

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[203] Gaurav Jetley & Xinyu Ji 'Appraisal arbitrage: Is there a Delaware advantage?' (2016) 71 (2) *Business Law* at 427. See also: RA Booth 'The real problem with appraisal arbitrage' (2017) 72 *Business Law* at 325 argues that the extension of appraisal rights to post announcement shareholders instead of to only pre-announcement shareholders is the primary cause of appraisal arbitrage.

[204] *In re Appraisal of Transkaryotic Therapies, Inc.*, No. *supra* note 140. The Delaware Court of Chancery held that where a shareholder purchased shares after the record date they could still exercise their appraisal rights, even though it was not clear whether or not the shares that were purchased had voted against or abstained from voting for the merger. The only limit that was placed by the court was that the number of shares must be less than the total number of shares that did not vote in favour of the merger. See also: Jiang et al op cit note 195 at 702 attributes this decision as one of the main reasons that there was an increase in appraisal litigation in Delaware in 2007.

[205] G Jetley & X Ji op cit note 203 at 433-455.

[206] Myers and Korsmo 'Reforming' op cit note 176 at 284.

[207] Hamermesh op cit note 202 at 5-6. Booth op cit note 203.

[208] Boyd op cit note 82 at 497.

minority shareholders to prey on unsuspecting companies. They are considered to be predatory and to be exploiting a statutory right. Norwitz[209] argues that:

> 'Appraisal arbitrage has nothing to do with the purpose for which the remedy was created. Appraisal rights – otherwise known as dissenters rights – were designed to provide a safety valve for shareholders of an acquired company who are dissatisfied with the consideration they are to receive, by allowing them to seek a judicial determination of the "fair value" of their shares. The remedy was not designed to create a new way for short-term speculators to game the system and profit at the expense of the broader shareholder body.'

The opponents of appraisal arbitrage have petitioned for the law to be amended primarily to remove the ability of arbitragers to acquire shares after a merger has been announced and a reduction in the financial benefits (adjudicated fair value and interest accrued) that can be received by a dissenting shareholder in appraisal proceedings.[210] Boyd argues that appraisal arbitrage negatively affects the corporate landscape.[211] Further criticism of appraisal arbitrage is that it has a negative effect on the price that is offered in respect of the transaction because the acquirers hold back on offering a high price in anticipation of having to pay a higher appraised value to the arbitragers.[212] Where a higher price is awarded by the courts, it can be argued that these arbitragers are diverting value to themselves and not shareholders from whom they acquired shares from.

Supporters of appraisal arbitrage argue that, appraisal arbitrage does not deviate from the purpose for which the remedy was created for. Myers & Korsmo [213] argue that:

> 'If it is consistent with the "purpose" of the appraisal remedy that a stockholder can avail herself of the appraisal remedy, there is no reason why that same purpose should not be served by the

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[209] Trevor S. Norwitz 'Delaware legislature should act to curb appraisal arbitrage abuses' 10 February *2015CLS Blue Sky Blog* available at *http://clsbluesky.law.columbia.edu/2015/02/10/delaware-legislature-should-act-to-curb-appraisal-arbitrage-abuses/* accessed 16 February 2018.

[210] Boyd op cit note 82 at 498. The 2015 amendments to the Delaware General Corporation Law to allow for pre-payment of a cash value to the dissenting shareholder prior to the court determination of fair value of the shares was introduced as a measure to reduce the interest that may accrue on shares that are the subject of appraisal rights proceedings.

[211] Ibid at 529. Boyd argues that appraisal arbitrage imposes consequences on the success of merger transactions because '[a]ctivists will publicly and aggressively encourage other stockholders to join in an appraisal action, "increasing the threat of the proceeding to the target board—and thus, as a result, the activist's leverage in negotiating a settlement," presenting a serious threat to the ultimate success of a deal.' He also argues that appraisal arbitrage puts the buyers and sellers in adversarial roles.

[212] TS Norwitz op cit note 211.

[213] Myers & Korsmo 'Reforming" op cit note 8 at 315-16.

transferee stockholder seeking appraisal in the same situation. Moreover, a principal goal-perhaps the principal goal-of any system of private stockholder litigation is deterrence, and from that point of view the identity of the plaintiff does not matter at all, so long as the claim is brought in the right circumstances.'

Based on empirical evidence, appraisal arbitrage has a positive effect on the initial offer price[214] and their acquisition of shares after the transaction announcement assists smaller minority shareholders who would not have had the capacity to pursue appraisal rights as a result of the high costs associated therein.[215] Myers & Korsmo, in support of appraisal arbitrage, argue that appraisal arbitrage is beneficial to the corporate landscape because it has increased the frequency of appraisal rights litigation and the threat of it should 'prevent acquirers from holding back value in merger negotiations' and this deterrent effect is indication that the legal system if functioning well.[216]

4.5. Conclusion

Despite the remedy being an exit mechanism, it can be effectively used to some extent as a tool for shareholder activism in proposed transactions as can be seen in the results of Mr Icahn's appraisal threats against Dell Computers. As the primary focus of the remedy is for the dissenting/activist shareholder to receive the 'fair value' of his/her shares from the company, the effect that the remedy primarily has is related to the price offered for shares in a proposed transaction. It has been argued that the appraisal remedy has an *ex ante* effect on the price that is offered by the company or an acquirer to shareholders i.e. the remedy ensures that the shareholders in general are not being short-changed by the management of the company.[217]

Also, the utilisation of appraisal right conditions precedent transactions can have an unintended effect of becoming a tool for shareholder activists to frustrate or terminate a proposed transaction, as was the case in the Sovereign Foods case. In a study conducted by some academics in the United States, it was noted that the use of appraisal right conditions precedent had decreased as a result of the appraisal remedy being evoked more frequently in the Delaware jurisdiction.[218] An activist shareholder or shareholders with a significant shareholding in a

[214] Scott Callahan, Darius Palia & Eric L. Talley 'Appraisal arbitrage and shareholder value' (2017) *Journal of Law, Finance & Accounting, Forthcoming* 5 at 5
available at https://scholarship.law.columbia.edu/faculty_scholarship/2062 accessed on 25 January 2018.
[215] Korsmo & Myers 'Appraisal rights arbitrage' op cit note 176 at 1555-1556.
[216] Myers & Korsmo 'Reforming' op cit note 176 at 285.
[217] Korsmo & Myers 'Appraisal rights arbitrage' op cit note 176 at 1576
[218] Boone et al op cit note 65.

company can effectively use the threat of exercising appraisal rights as leverage against the acquirer and the target company. However, such a strategy can back fire in that the threat of appraisal may stop a transaction that is beneficial to all shareholders from proceeding. The strategy relies on the premise that the acquiring company will be willing to revise the deal price and should the acquirer not be willing to do so, the acquirer will simply walk away from the transaction.

CHAPTER 5: THE DEVELOPMENT OF SHAREHOLDER ACTIVISM IN SOUTH AFRICA

5.1. Introduction

Until fairly recent, shareholder activism was not very prominent in South Africa and instances of shareholder activism were very limited. The introduction of foreign shareholders in the corporate sector has broadened the shareholder base of many companies and the regulatory framework in South Africa has created an environment for shareholder activism that is being embraced with increasing levels of participation.[219] In South Africa, the primary shareholder activists are individual shareholder activists, with institutional shareholders slowly starting to take action. It must be noted that some of the prominent individual shareholders are linked to or act for an institution as well, which institution they utilise to exert influence on the company and its directors. Both individual and institutional shareholders are concerned with a wide variety of causes which include, *inter alia*, financial reporting, corporate governance and executive remuneration matters. The use of appraisal rights as a tool for shareholder activism can be seen in the United States[220] and it appears that South African shareholder activists have also begun to use the remedy in a similar manner.[221]

The South African corporate sector is familiar with the names of Theophilous 'Theo' Botha, Chris Logan and Albertus Cilliers, who are prominent individual shareholder activists. In the arena of institutional shareholder activists, the PIC and Allan Gray have arisen as active participants in the affairs of some of the companies that they invest in. For example, Allan Gray took activist action against Sasol Limited's remuneration scheme in 2011 and most recently took extreme activist action by convening a shareholder meeting in terms of section 61 of the Companies Act[222] to reconstitute the board of directors of Group Five Limited in 2017. Allan

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[219] Ezra Davis and Xolani Ntamane *The Shareholder Rights and Activism Review* 2ed Francis Aquila (2017) at 100 available at *https://www.bowmanslaw.com/wp-content/uploads/2017/10/The-Shareholder-Rights-and-Activism-Review-South-Africa-Chapter.pdf* accessed 18 October 2018. The regulatory frameworks that relate to companies include the Companies Act, the Regulations, the JSE Listings Requirements (if a listed entity) and the King IV Report on Corporate Governance for South Africa, 2016.

[220] D Katz op cit note 8 at 814.

[221] In 2016 shareholder activists exercised their appraisal rights against Sovereign Food Investment Limited when the company proposed an empowerment transaction which utilised a scheme of arrangement to acquire the shareholders' share on a pro rata basis. In 2017 shareholder activist, Albertus Cilliers, exercised his appraisal rights twice against KWV Holdings Limited and against Gooderson Leisure Group. The former case is lauded as being the first case in which fair value will be determined in terms of appraisal rights.

[222] Section 61 provides shareholders holding more than 10% of the voting rights of a company with the right to demand or requisition a meeting of shareholders should the directors be unable to.

Gray's actions resulted in 5 board members resigning from Group Five. Institutional shareholder activists also get involved in corporate actions as can be seen from the public dissent voiced by institutional shareholders of PPC in the recently proposed merger with AfriSam Group Proprietary Limited (AfriSam), a smaller competitor of PPC Limited (PPC). The Companies Actions of these institutional activists in the AfriSam and PPC will be discussed in further detail later in this chapter.

Mr Botha, has taken companies to task on matters of corporate governance, executive compensation, environmental management and black economic empowerment.[223] His corporate activism began with his actions against the Sage Group in 2002 wherein his actions of querying the omission of disclosure of the company's United States operations in its annual financial statements resulted in the company's share price plummeting and its credit rating being downgraded.[224] He Botha's shareholder activism has continued over the years and he has been involved in shareholder action wherein he publically encouraged Coronation Fund Managers' shareholder to vote against the proposed directors' remuneration at the annual general meeting held in 2017. Most recently he initiated action to table a shareholder resolution[225] for consideration at Sasol's annual general meeting, which action was blocked by the Sasol board of directors.[226] Mr Botha is described as 'the most vocal and prolific shareholder activist in South Africa.[227]

Mr Logan is an asset manager of Opportune Investments and he is predominantly known for his actions and efforts that resulted in the unbundling of the Standard Bank and Liberty Holdings pyramid structure in 2008.[228] He was also one of the first shareholders to attempt to

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[223] The companies that Mr Botha has engaged with include Sage Group Limited, Sappi Limited, Absa Bank, Sasol Limited, SABMiller Limited, Pick n Pay Stores Limited, Tiger Brands Limited, Anglo American PLC, Bidvest Limited, Wesizwe Platinum Limited, The Standard Bank and Liberty Holdings Limited.

[224] S Viviers op cit note 175 at 348-349.

[225] Section 65(3) of the Companies Act makes provision for two shareholders of a company to propose a resolution concerning any matter in respect of which they are entitled to exercise voting rights and following making such proposal, require that the resolution be submitted to shareholders for consideration at a meeting of shareholders.

[226] Ann Crotty 'How 'new' Companies Act is no aid to shareholder activists' Business Day available at *https://www.businesslive.co.za/bd/business-and-economy/2018-08-02-how-new-companies-act-is-no-aid-to-shareholder-activists/* accessed 4 August 2018.

[227] S Viviers op cit note 175 at 350.

[228] Shaun Harris 'Beep, beep…Access denied' 27 March 2008 Fin24 Archives available at *https://www.fin24.com/Finweek/Companies/Beep-beep-Access-denied-20080324* accessed 4 August 2018. See also: Marc Hasenfuss 'Nitpickers are often necessary beasts' 30 April 2015 Business Day available at *https://www.businesslive.co.za/bd/companies/investors-monthly/2015-04-30-nitpickers-are-often-necessary-beasts/* accessed 4 August 2018.

use the provisions of the Companies Act as a tool for shareholder activism as early as 2011 when he attempted to propose a shareholder resolution at the annual general meeting of KWV Holdings Limited (KWV).[229] This proposal attempt was unsuccessful but this did not deter Mr Logan. His shareholder activist actions have continued over the years and he has been vocal in the press in regard to the companies that he is invested in (usually as a minority shareholder). Most recently he unsuccessfully attempted to propose a shareholder resolution at the annual general meeting of Trencor pursuant to which he hoped to encourage the board to use its influence to make changes to the by-laws of a company that Trencor holds a 48 per cent interest in.[230]

Mr Cilliers' shareholder activism has been primarily focused on transaction related matters. He is currently engaged in two appraisal rights cases against KWV Holdings Limited, now trading as La Concorde Holdings (La Concorde) where the company disposed of a substantial part of its assets to Vasari Global (Vasari) and secondly, he has exercised his appraisal rights in the Gooderson Leisure Group's delisting from the Johannesburg Stock Exchange (JSE). It must be noted that he was also involved in the Sovereign Foods case, discussed in previous chapters and in more detail in this chapter.

5.2. Instances where the appraisal rights remedy has been exercised or threatened by shareholder activists in South Africa

5.2.1. KWV Holdings Limited's disposal of majority of assets

Mr Cilliers has become a name associated with appraisal rights and shareholder activism as result of his exercise of appraisal rights against La Concorde when the company proposed to dispose of its operational assets to Vasari for a value of R1.15 billion which translated to a price of R16.91 per share. The independent expert that was appointed to opine on the fairness of the sale consideration considered the terms of the offer to be fair and reasonable on the basis of it determining a valuation range of the sale assets of between R753 million and R852 million, with a most likely value of R832 million, which translated to a per share value of R13.47 prior to implementation of the sale. The sale was finalised in October 2016 and pursuant to his appraisal rights Mr Cilliers demanded that La Concorde buy back its shares from him.

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[229] Ann Crotty 'Minority shareholder rights take knock as KWV rules out proposal' Business Report 27 October 2011 available at *https://www.iol.co.za/business-report/economy/minority-shareholder-rights-take-knock-as-kwv-rules-out-proposal-1165523* accessed 17 April 2017.
[230] A Crotty op cit note 228.

La Concorde made an offer of R13.47, which is in line with the independent expert's fair value assessment of the sale. However, Mr Cilliers, rejected the value of R13.47 per share determined by the independent expert on the basis that it is not reflective of the fair value of his shares and has argued that the fair value of the shares is approximately R20 and effectively demands that La Concorde purchase his shares at this price.[231] After filing his action in the Western Cape High Court, La Concorde challenged Mr Cilliers' entitlement to exercise his appraisal rights on the basis that KWV's assets were held in a wholly owned subsidiary while Mr Cilliers' shares were held in KWV and as a result Mr Cilliers did not hold shares in the company which sold its assets to Vasari and no appraisal rights had been triggered. The Court rightly rejected this argument and held that Mr Cilliers was entitled to exercise his appraisal rights against La Concorde.[232]

5.2.2. Gooderson Leisure Group delisting

In July 2016 Gooderson proposed a scheme of arrangement wherein a 72 per cent major shareholder of the company, ALJU Family Trust, offered to purchase all the shares of the company that it did not own from Gooderson shareholders and to delist the company from the JSE. Pursuant to the scheme of arrangement, the initial offer price per share was 65 cents per share, which was later revised in October 2016 to 85 cents per share. As required by the Companies Act, the independent board of Gooderson appointed an independent expert for purposes of opining on the fairness and reasonableness of the offer price. The independent expert provided an opinion that the offer price of 85 cents was not fair but was reasonable as it was higher than the trading price of the shares on the JSE.

The scheme of arrangement was approved by the requite majority of shareholder on 22 December 2016, however, as a result of receiving objections and dissenting votes, the scheme could not be finalised until 18 January 2017. The primary objections received were raised by Mr Cilliers, who was discontent with the offer price even though it had been accepted by majority of the minority shareholders. His discontent with the offer price was not unfounded as the independent expert had valued the Gooderson shares at a fair value of 130 cents per share. As at the date of this study, Mr Cilliers has exercised his appraisal rights in this regard

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[231] Ann Crotty 'Battle Looms over KWV sale' Business Day 26 October 2016
available at *http://www.bizcommunity.com/Article/196/163/152790.html* accessed 24 November 2016.
[232] *Cilliers v LA Concorde* supra note 5 at 9.

and the matter remains to be adjudicated by the courts. In an online news article on the matter Mr Cilliers' motivation is premised on the fact that:

> 'There is a good intention behind appraisal rights — like acting as a check against opportunistic management. But companies seem to be able to put up too many hurdles. I intend going to court, otherwise companies will get away with it all the time.'[233]

What is interesting about this case is that the independent expert has already opined that the price offered was not fair and has attributed a higher value as to be the fair value. It is unlikely that the courts would determine the fair value to be the price that was offered and mostly likely the courts will determine a price closer to the independent experts assessed value of R1.30 per share.

5.2.3. The PPC and AfriSam proposed merger

Following the firm intention announcement by PPC regarding the partial offer by Fairfax Africa Investments backing AfriSam to PPC shareholders on 4 September 2017, PPC received several letters from shareholders holding approximately 25 per cent of share the company's shares which disagreed with the price offered for PPC shares.[234] Prudential Investment Managers, Value Capital Partners and Visio Capital publically voiced their dissent to the price of R5.75 per share on the basis that this price did not reflect the potential value that could be realised from PPC's investment in its operations in South Africa and other African countries. Prudential Investments Managers' chief executive officer, Chris Wood, stated that based on its assessment it saw the shares of PPC having a future value of R12 per shares, while Value Capital Partners quoted a value of R10 per share for PPC shares. [235] The general sentiment amongst these institutional shareholders was that PPC was undervalued and was not reflective of the true/fair value of the PPC shares. Essentially these institutional shareholders had the power to vote down the transaction as they held more than 25 per cent in aggregate of PPC's shares, and should they not have had this veto power, and the transaction was approved, based

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[233] Marc Hasenfuss 'Gooderson Leisure draws ire of dissenting shareholder' Financial Mail 26 January 2017 available at (*https://www.businesslive.co.za/fm/money-and-investing/2017-01-26-gooderson-leisure-draws-ire-of-dissenting-shareholder/* accessed 26 February 2017.

[234] Arabile Gumede 'PPC says more than 25% of shareholders oppose AfriSam merger' 6 October 2017 available at *https://www.iol.co.za/business-report/companies/ppc-says-more-than-25-of-shareholders-oppose-afrisam-merger-11505620* accessed 15 November 2017.

[235] Ray Mahlaka 'Why the PPC, AfriSam tie-up is facing rebellion' 9 October 2017 available at *https://www.moneyweb.co.za/news/companies-and-deals/why-ppc-afrisam-tie-up-is-facing-shareholder-rebellion/* accessed 27 November 2017. Ray Mahlaka 'High noon looms for PPC/AfriSam merger' 22 November 2017 available at *https://www.moneyweb.co.za/news/companies-and-deals/high-noon-looms-for-ppcafrisam-merger/* accessed 27 November 2017.

on their self-evaluations of the 'fair' value of their PPC shares, they could have challenged the offer price by exercising their appraisal rights. It is interesting to note that the AfriSam was subsequently abandoned in December 2017 (resulting in an increase in its share price) and following pressure from disgruntled shareholders, the CEO of PPC subsequently resigned in March 2018.[236]

5.2.4. Sovereign Food Investments Limited (Sovereign) vs Country Bird Holdings Limited (CBH) vs Other Shareholder Activists

In late 2015 Sovereign proposed a BEE transaction in terms of which the company by way of a scheme of arrangement proposed to repurchase a maximum of 10 per cent of its shares at a price of R8.50 per share which would be allocated to a BEE partner to increase the BEE ownership of the company. The scheme of arrangement gave Sovereign shareholders the right to exercise their appraisal rights and CBH, a competitor to and a minority shareholder in Sovereign, and other minority shareholders, decided to exercise their appraisal rights (11 per cent of Sovereign's shares in issue) as they disagreed with the transaction on the basis that the transaction would give the management of Sovereign more control and hinder any future attempts of a takeover.

The company obtained 85 per cent shareholder approval for the transaction and the dissenting shareholders holding 11 per cent pursuant to the requirements of the Companies Act did not vote in favour of the transaction. However, the company had included a condition precedent to the transaction that stated that the transaction was conditional on not more than 5 per cent of the company's shares giving notice of exercising their appraisal rights or alternatively, should shareholders give notice, not more than 5 per cent of the company's share having validly given their demands within 25 business days following the distribution of the notice of adoption of the transaction resolution. CBH and the other minority shareholders validly made their demands pursuant to section 164(5) to 164(8) of the Companies Act and on this basis contended that the transaction had failed and could not be implemented.[237]

Sovereign subsequently proposed revocation of the initial transaction and approval of a revised transaction which repurchased only 5 per cent of the company's shares (thus did not trigger appraisal rights) and which excluded dissenting shareholders of the initial transaction from voting. The dissenting shareholders made an application to the court to have the initial

[236] Ibid 'Why the PPC, AfriSam tie-up is facing rebellion'.
[237] *Juspoint Nominees v Sovereign Foods* supra note 4 para 2.

transaction declared to have been of no force and to have never have become operative or effective. This application was joined by Mr Cilliers as an intervening party seeking an order from the court that the Companies Actions of Sovereign's management in excluding dissenting shareholders of the initial transaction to be unfairly prejudicial and sought relief pursuant to section 163 of the Companies Act in February 2016. The court ruled in favour of the dissenting shareholders and since the initial transaction had never come into operation, the second transaction that sought to revoke the initial transaction was itself null and void *ab initio*, this sufficed as relief pursuant to Mr Cillier's application.[238]

In July of 2016, CBH and its concert parties subsequently made a hostile takeover offer to Sovereign Foods shareholders at a price of R9 per share. Interestingly, the CBH offer was not supported by other shareholder activists of Sovereign Foods such as Chris Woods of Prudential Investments who publically voiced his disapproval of the hostile takeover offer. When a challenge regarding the fulfilment or lapsing of the offer was raised by Sovereign Foods, Prudential Investments supported the company's submission to the Takeover Regulation Panel and wrote a letter to the Panel requesting that it declare the offer to have lapsed. [239] The challenge resulted in the offer being ruled to have lapsed and as a result was unsuccessful. Chris Woods did support a later offer made by another party in August 2017 for R12 per share which he described as 'closer to fairer value' for Sovereign shares.[240]

South Africa continues to follow the global shareholder activist trends as it has been recently announced that South Africa's first activist fund will be launched by Sygnia Limited, a specialist financial services group listed on the JSE.[241] The primary focus of the fund will be to buy shares in listed companies that are 'trading at deep discounts to net asset value or which it perceives to have either a weak strategy, weak management team or weak corporate governance.

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[238] Supra para 87.

[239] Ann Crotty 'Sovereign Foods: No end in sight in bid battle' Financial Mail 18 November 2016 available at *https://www.businesslive.co.za/fm/money-and-investing/2016-11-18-sovereign-foods-no-end-in-sight-in-bid-battle/* accessed 16 February 2018.

[240] Ann Crotty 'No sign of bidding war for Sovereign' Business Day 21 August 2017 available at *https://www.businesslive.co.za/bd/companies/retail-and-consumer/2017-08-21-no-sign-of-bidding-war-for-sovereign/* accessed 16 February 2018.

[241] Prinesha Naidoo 'Magda Wierzycka to launch activist fund' available at *https://www.moneyweb.co.za/news/companies-and-deals/magda-wierzycka-to-launch-activist-fund/* accessed on 28 May 2018.

5.3. Conclusion

The use of the appraisal rights remedy as a tool for shareholder activism is still in its infancy in South Africa, however, the above stated actions by shareholder activists illustrate that the tide of shareholder activism is increasing in South Africa. To a certain extent the anti-appraisal mechanisms that companies use in order to limit the risk of dissent, facilitate and propel shareholder activism in corporate transactions. For example, an approach to shareholders in terms of the 'rule of 5' permits shareholders (both majority and minority shareholders) to voice any concerns that they may have in respect of a transaction. I submit that it only a matter of time before more appraisal shareholder action and litigation becomes a common feature in South Africa.

CHAPTER 6: CONCLUSION

6.1. Introduction

The appraisal right remedy in the Companies Act is novel to the South African legal landscape and its presence had not been a matter of interest. It is only until recently, when certain cases involving aspects of appraisal rights were brought before the courts, that the remedy has become an active topic of discussion again.[242] It cannot be ignored that the persons that have attempted to utilise this remedy have been dubbed shareholder activists. However the protection / utility of the appraisal remedy as a tool for minority shareholders or shareholder activists is limited. The limitations of the appraisal remedy are inherent in the nature of the right. The remedy imposes a stringent procedure that requires strict adherence by the dissenting shareholder. Should the shareholder fail to be sophisticated enough to follow each and every step, the statutory right falls away without any possibility of being resuscitated again. The dissenting shareholder carries the burden of ensuring that its right does not lapse throughout the process.

In addition to the above, a dissenting shareholder must also bare the additional burden of incurring litigation costs, delayed receipt of the court determined fair value of the shares and experiences great uncertainty regarding the outcome of such court determined fair valuation. Interestingly enough, a company that is considering implementing a transaction that gives rise to appraisal rights has similar concerns in that it will also have to dedicate time, incur costs, comply with procedural requirements and potentially pay a higher than anticipated value for the dissenting shareholders' shares. As a result appraisal rights are taken into consideration in the structure, terms and conditions and implementation of the transactions.

The above issues and concerns of dissenting shareholders and companies were inherited by the South African legal system when the Companies Act incorporated appraisal rights which were created in the United States. The Companies Act borrows provisions from the Model Business Corporations Act and the Delaware General Corporation Law and seeks to provide minority shareholders with the protections that were believed to be necessary when they lost their power to veto.[243] In South Africa the appraisal right remedy was introduced as compensation for the

[242] *Juspoint Nominees v Sovereign Foods* supra note 4, *Loest v Gendac* supra note 4, *Cilliers v LA Concorde Holdings* supra note 5.

[243] B Manning op cit note 7 at 614-15.

removal of the courts' jurisdiction in the approval of certain transactions, effectively acting as a quid pro quo replacement.

6.2. Discussion on findings of the research

Companies and their boards and management are concerned about triggering appraisal rights as it cannot be disputed that the Companies Act is generous in the number of instances that it grants appraisal rights, especially when it is compared to the statutes that it is modelled after, the Model Business Corporations Act and the Delaware General Corporation Law. This would logically mean that South African companies would seek to either avoid or limit the impact that appraisal rights will have on a proposed transaction.

It can be observed that in both the United States and South Africa, a company has a number of mechanisms at its disposal for purposes of minimising the risk of appraisal rights being exercised in a proposed transaction, which include the methods of garnering support for a transaction by approaching shareholders, utilising non-triggering transactions, protecting itself and the acquirer by including appraisal right conditions precedent and including a provisional revocation resolution have become common practice. However it can be seen that these anti-appraisal mechanisms have the ability to take away the availability of the remedy from the dissenting shareholders, although the severity of the limitation on the appraisal rights remedy differs with each mechanism.

Although these anti-appraisal mechanisms can affect the occurrence or enforcement of appraisal rights, they cannot be applied to all situations as certain corporate actions such as the disposal of a greater part of a company's assets, expropriation of all or a portion of a company's shares, merger or amendment of a company's memorandum cannot be implemented through the use of the alternative takeover method. This is supported by the fact that despite corporate actors being concerned with appraisal rights, several fundamental transactions have been proposed and approved by shareholders without the incidence of appraisal rights being exercised.

These anti-appraisal mechanisms are being used in the United States to various extents. What is interesting to note is that despite there being an increase in appraisal arbitrage and open opposition to the use of anti-appraisal mechanims,[244] companies in the United States have

[244] *Dr Pepper* case supra 159.

reduced their use of measures that limit the occurrence or enforcement of appraisal rights, in particular the appraisal right condition precedent.[245] The reduction in the utilisation of these measures may be attributed to commercial considerations of an acquirer not being interested in walking away from the proposed transaction, the confidence that the acquirer has in the fairness of the offer price combined with the developing sense of certainty of how the courts may determine the fair value of the shares to be the offered price or alternatively from the additional risk that such a condition adds to the already uncertain process of triggering appraisal rights.[246] The reduction in use of appraisal rights conditions precedents may also be attributed to the fact that the condition can be utilised by shareholder activist as a tool to frustrate the implementation of the proposed transaction.[247]

The appraisal rights remedy has a governance aspect to it in that it deters management from proposing transactions that would not be to the benefit of shareholders. The development of appraisal arbitrage, mostly spearheaded by activist investors in the United States, was only inevitable as the appraisal rights remedy is inherently a tool for shareholder activism. The second use of the appraisal rights remedy is that it protects the interests of a dissenting shareholder when management has failed to be deterred from proposing a transaction that offers shareholders a consideration that is not fair.[248]

Shareholder activists can utilise some of the mechanisms that a company may use to attempt to neutralise minority shareholders to their benefit. For example, should a company approach a shareholder activist for purposes of garnering support for a proposed transaction, the shareholder activist can utilise this platform to raise questions and to make it clear to the company that it believes the consideration offered in not fair. This would prompt the acquirer to make a higher initial offer price. An appraisal rights condition precedent can be utilised as leverage against the company by a shareholder activist and essentially hold the company and acquirer at ransom stoping the company and the acquirer from implementing the transaction.

As a result of the appraisal rights being exercised more in transactions where there has not been an arms-length negotiation process, where there are interested parties and where the offer price is not at a high premium, companies in the state of Delaware would endeavoured to ensure that

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[245] Boone et al op cit note 65 at 24.
[246] Myers & Korsmo 'Reforming" op cit note 8 at 284.
[247] Ibid.
[248] Cassim et al 'Contemporary Company Law' op cit note 9 at 797.

they undergo a transparent and fair process before they propose a triggering transaction to shareholders.[249] This careful approach by companies is in line with the good corporate governance that shareholders seek to be present in all company dealings and behaviour.

It is apparent that South African shareholder activists have taken note of the utility of the appraisal remedy as a tool for shareholder activism.[250] It is interesting to note that in the few instances that the issue of appraisal rights has been raised in the courts the applicant in such matters was a shareholder activist. Continued presence and efforts of shareholder activists in the arena of fundamental transactions can counteract the neutralisation of the appraisal right and have the resultant effect of developing the appraisal right jurisprudence in South Africa. It can be argued that the threat of exercising the appraisal rights remedy by shareholder activists can have a positive benefit for all shareholders involved in proposed transactions in that it can result in all of the shareholders receiving a higher premium for their shares.[251]

However, the strength of the appraisal rights remedy as a tool for shareholder activists is also limited in its reach. The remedy is an exit mechanism for minority shareholders and has the primary effect of removing the shareholder activist from the company. Its only benefit is that of providing a shareholder with the power to demand payment of the fair value of his/her shares. Where the threat of exercising the appraisal rights remedy does not result in a reconsideration of the offer price for all shareholders the exercise and enforcement of the remedy only benefits the few shareholders that have their shares adjudicated by the courts.[252] The rest of the shareholder body will be paid the offer price.

It is submitted that shareholder activism has created sophisticated shareholders that are aware of their rights to appraisal and have the time and money to pursue the determination of fair value of shares by the courts. Shareholder activism has a role to play in the development of appraisal right litigation in South Africa and may be the catalyst that South Africa requires in order to propel other minority shareholders to pursue the appraisal rights remedy as an avenue in the future. However, shareholder activism alone is not enough and there are amendments to the appraisal right provisions in the Companies Act that the South African legislature may consider to make the remedy more accessible to dissenting shareholders.

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[249] Scott Callahan et al. op cit note 216 at 5

[250] Refer to chapter 4 of this dissertation.

[251] Myers & Korsmo 'Reforming' op cit note 176 at 285.

[252] Jiang et al op cit note 200 at 11.

6.3. Recommendations and conclusion

It is recommended that the legislatures should consider:

(a) Extending the application of appraisal rights to the other takeover mechanisms that can be utilised to effect a change in the control of the company, such as mandatory offers, general offers and section 124 squeeze outs of minority shareholders. This would ensure that there is consistent application of the appraisal right in respect of all corporate actions that have the ability to alter a company and where a price is offered to a shareholder.

(b) The inclusion of a provision in the Companies Act stating whether a shareholder can explicitly waive his/her right to seek appraisal by contractual means. It is recommended that the provision allow for the waiver of the appraisal right on a personal capacity as this is permissible in terms of the laws of contract.

(c) Introducing a pre-payment mechanism which allows the company to pay the dissenting shareholder a cash amount prior to the courts determining the contested 'fair value' of the contested shares. This would allow the company to proceed with the transaction and only leave the contested portion of the value shares in debate. In an economic climate such as South Africa, this would provide a dissenting shareholder with some liquidity in their finances and permit them to put the proceeds toward defending their appraisal litigation.

(d) Introducing additional guidelines with regard to the determination of 'fair value' of shares. The guidelines do not need to be prescriptive but merely highlight the considerations that the court should consider when attempting to determine the fair value of shares. This would reduce some of the uncertainty of companies and dissenting shareholders alike and reduce the need for anti-appraisal mechanisms.

These collective changes to the Companies Act would assist in ensuring that the utilisation of some of the anti-appraisal remedies in reduced and that appraisal rights remedy lived up to its purpose which is to assist minority shareholders.

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