Fundamental transactions and their regulation by the Companies Act No. 71 of 2008

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The new Companies Act No. 71 of 2008 (the Act) is expected to become effective this year. The Act re-writes South African company law completely and will have far reaching effects.

One of the highlights of the new Companies Act No. 71 of 2008 (the Act) is its innovation in the area of “fundamental transactions” by which mergers and acquisitions are effected and the fact that the Act regulates fundamental transactions more stringently than the Companies Act No. 61 of 1973 (the old Act) did.

**Categories of fundamental transactions**

The Act contains distinct requirements for each of the four categories of fundamental transactions identified in the Act, which may be described as follows:

- disposals of all or the greater part of a company’s assets or undertaking;
- mergers and amalgamations;
- schemes of arrangement; and
- takeovers.\(^1\)

**The Takeover Regulation Panel**

The Act establishes the Takeover Regulation Panel (Panel) as a replacement for the old Securities Regulation Panel. The Panel governs fundamental transactions undertaken by regulated companies (being public companies, state-owned companies and certain private companies) and will prescribe additional rules for those transactions.

Every regulated company will need to obtain a compliance certificate from the Panel before it may implement a fundamental transaction, and this applies to all fundamental transactions, not only takeovers.

**Disposals of assets**

A disposal only needs to comply with the Act where a company is disposing of all or the greater part of its assets or undertaking. Where the company disposes of only a part of its assets or undertaking, the determination of whether the part being disposed of constitutes the greater part of its assets or undertaking is based on the fair market value of the company’s assets or undertaking.

The requirements for a disposal by a company of all or the greater part of its assets or undertaking are that:

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\(^1\) Since there is no distinction in the Act between a merger and an amalgamation, the term “merger” may effectively be used interchangeably with the term “amalgamation.”

\(^2\) The term “takeovers” loosely refers to transactions in the shares of a company which are commonly used to acquire control of a company.
such disposal shall have been approved by special resolution of the shareholders of that company;
- in certain circumstances, the general rules applicable to fundamental transactions (which are set out below) may require the approval of the shareholders of a holding company of the company making the disposal and of a court; and
- if the company making the disposal is a regulated company, the Panel shall have issued a compliance certificate in respect of that disposal.

However, these requirements do not apply to a disposal:
- which is effected pursuant to a business rescue plan; or
- between a wholly-owned subsidiary on the one hand and any one or more of its holding company and any other wholly-owned subsidiary/ies of that holding company on the other hand.

Mergers

For the first time in South African law, the Act enables companies to effect a merger per se, where a company may transfer its liabilities (as well as its assets) to another company without the consent of its creditors.

Under the enabling provision of the Act, any two or more companies (including holding and subsidiary companies) may, subject to satisfying the solvency and liquidity test, merge by entering into a transaction which results in either:
- the formation of one or more new companies which together hold all of the assets and liabilities that were previously held by the merging companies immediately prior to the implementation of the merger, and the dissolution of each of the merging companies; or
- the survival of one or more merging company/ies, with or without the formation of one or more new companies, which acquire all of the assets and liabilities previously held by the merging companies immediately prior to the implementation of the merger.

The requirements for a merger by a company with any other company are that:
- the terms and means of effecting the merger, and certain other prescribed matters, must be set out in a written agreement (merger agreement) between the merging companies;
- the board of directors of each merging company must reasonably believe that each merged entity will satisfy the solvency and liquidity test upon implementation of the merger;
- the merger shall have been approved by special resolution of the shareholders of each merging company;
- in certain circumstances, the general rules applicable to fundamental transactions (which are set out below) may require the approval of the shareholders of a holding company of the merging company and the approval of a court;
- every known creditor of the merging companies must have been notified of the merger. Any creditor of a merging company may challenge the merger in court if the court is satisfied that the creditors are:
  (i) acting in good faith;
  (ii) will be materially prejudiced by the merger; and
  (iii) have no other remedies; and
- if any merging company is a regulated company, the Panel shall have issued a compliance certificate in respect of that merger.

However, these requirements do not apply to a merger which is effected pursuant to a business rescue plan.

Although there are procedural safeguards for creditors in the merger process, creditors may still feel at risk as a result of the possibility that their debtors could transfer their liabilities to other companies in terms of a merger. This is likely to open a new issue of contention between creditors and their debtors, as creditors are likely to seek advance contractual protection against the possibility of a merger without their consent.

Schemes of arrangement

The scope of the concept of a scheme of arrangement between a company and its shareholders has been clarified in the Act, as a scheme of arrangement now expressly includes any arrangement between the company and its shareholders by way of:
- a consolidation of securities of different classes;
- a division of securities into different classes;
- an expropriation of securities from the holders;
- exchanging any of its securities for other securities;
- a re-acquisition by the company of any of its securities; or
- a combination of any of these methods.

In an approach which entails a few departures from the old Act’s requirements, the requirements for a company to implement a scheme of arrangement under the new Act are that:
- the scheme shall have been proposed by the board of directors of the company and shall have been approved by special resolution of the shareholders of that company;
- the sanction of a court is not ordinarily required, but in certain circumstances, the general rules applicable to fundamental transactions (which are set out below) may require the approval of a court and the approval of the shareholders of a holding company of the company implementing the scheme;
- the company must appoint an independent expert, who satisfies the Act’s criteria on independence and expertise and that independent expert must prepare a report on the scheme to the board of directors and cause the report to be distributed to all shareholders. The independent expert’s report must contain certain prescribed minimum information, including an evaluation of any material adverse effects of the proposed arrangement against the compensation that will be received by affected shareholders and against any reasonably probable beneficial and significant effects of the scheme on the business and prospects of the company; and
- if the company implementing the scheme is a regulated company, the Panel shall have issued a compliance certificate in respect of that scheme.

However, the board of directors of a company which is in liquidation or in the course of business rescue proceedings may not propose a scheme of arrangement.

General rules applicable to fundamental transactions other than takeovers

Shareholder approval

As mentioned above, a company may not implement a disposal of assets, merger or scheme of arrangement without the approval of its shareholders, which must be given by way of a special resolution. In order for that resolution to be validly adopted:
- a meeting of shareholders must be called to consider the resolution and notice of that meeting must be given to shareholders in the prescribed manner. That notice will have to include various items of information, including explanations of the rights of shareholders to sell their shares to the company under the appraisal rights and have a court review the transaction (both of which are explained further below);
- ordinarily, the resolution must be supported by 75% of the votes cast on the resolution at a quorate meeting, although this percentage may be varied in the company’s Memorandum of Incorporation;
- votes controlled by an acquiring party (together with its related persons and concert parties) must be ignored when determining whether the meeting was quorate and whether the resolution received the required support.

In addition, where the transaction involves a disposal by a subsidiary company and the assets or undertaking being disposed of also constitute all or the greater part of a majority of the assets or undertaking of the holding
company of that subsidiary when one has regard to the consolidated financial statements of that holding company, then the approval of the shareholders of that holding company by way of special resolution is also required.

**Court review of fundamental transactions**

The approval of a court for a fundamental transaction (other than a takeover) will now be essential for disposals of assets, mergers and schemes of arrangement if:

- the special resolution approving the transaction was opposed by 15% or more of the votes cast on that resolution and any person who voted against the transaction requires the company to obtain such approval; or
- a court grants any shareholder leave to have the transaction reviewed. The court may only grant such a review if that shareholder:
  - is acting in good faith;
  - appears prepared and able to sustain the proceedings; and
  - has alleged facts which, if proved, would justify the court setting aside the resolution approving the transaction.

Where the court’s approval is required, the court will only be able to set aside the special resolution approving the transaction if:

1. The transaction is manifestly unfair to any class of the company’s shareholders; or
2. The vote on the transaction was materially tainted by (a) conflict of interest; (b) inadequate disclosure; (c) failure to comply with the Act, the company’s rules or Memorandum of Incorporation; or (d) other significant and material procedural irregularity.

**Appraisal rights**

One of the most innovative features of the Act is the fact that it grants appraisal rights to dissenting shareholders whenever the company adopts a resolution approving a fundamental transaction. (The appraisal rights are also available when a company amends its Memorandum of Incorporation so as to alter the rights attaching to any class of shares in a manner adverse to the holders of those shares.)

Shareholders who unsuccessfully oppose such transactions will thereafter be able to compel the company to repurchase all of their shares for their fair value, unless a court orders otherwise. However, apart from a situation in which the company would be plunged into illiquidity as a result of that repurchase, the grounds on which the court may order otherwise are not clear.

**Takeovers**

While many of the rules governing takeovers are familiar and have been in place for many years under the Securities Regulation Code which was promulgated under the old Act, the Act does introduce some new rules and also itself sets out more of the substantive rules so that it leaves less to be prescribed by regulation. In the process, the Act has improved and clarified some of these rules. Some brief highlights from the Act’s rules on takeovers are set out below.

**Takeover offers**

The Act obliges a person (acquirer) to make a mandatory offer to all shareholders of a company if, as a result of an acquisition by the acquirer or a share buy-back, the acquirer holds the prescribed percentage (which is expected to remain at 35%) or more of the voting shares of a company.

The Act also regulates the manner in which the acquirer must make a mandatory offer, and also regulates the manner in which partial offers and offers to acquire all of the shares in a company must be made.

**Partial offers**

A partial offer which would result in the offeror holding at least 35% but less than 100% of the issued shares of a company, must be conditional on the partial offer being approved by the independent holders of the company’s shares.

**Compulsory acquisitions and squeeze outs**

Where an offer has been accepted by 90% of the offeree shareholders, the Act enables the offeror to squeeze out the remaining minority shareholders by acquiring their shares on the terms of the original offer. The Act enables a court to come to the assistance of the offeror who has not been able to achieve the 90% threshold because offeree shareholders could not be traced.

In that situation, if the consideration offered is fair and reasonable and the court is satisfied that, having regard to the number of offeree shareholders who have been traced but did not accept the offer, it is just and reasonable to do so, the court may allow the offeror to invoke the squeeze out rule.

**Required disclosures on crossing thresholds**

Any person who acquires or disposes of a company’s shares is obliged to notify the company of that fact if the aggregate shareholding of that person reaches or drops below any whole multiple of 5% (for example, 5%, 10%, 15%, etcetera) as a result of that acquisition or disposal.

Any company receiving such a notice is obliged to file a copy of the notice with the Panel and, unless the transaction involved less than 1% of the company’s shares, report the contents of that notice to its shareholders.

**Concert parties and related persons**

The Act retains the concept of acting in concert (acting pursuant to an agreement between persons in terms of which they co-operate for the purposes of entering into or proposing a takeover) and generally aggregates the shareholdings of concert parties and related persons for the purposes of determining whether the various thresholds have been reached.

**Restrictions on frustrating action**

In order to prevent a board of directors of a company from taking frustrating action while the board believes that a bona fide offer is imminent or when a bona fide offer has been received, the Act restricts the board from:

- taking any action that could result in that offer being frustrated or the shareholders of the company being denied an opportunity to decide on the merits of that offer;
- issuing new shares or convertible securities or granting options to subscribe for new shares or convertible securities;
- selling or disposing of or acquiring assets of a material amount, except in the ordinary course of business;
- entering into contracts other than in the ordinary course of business;
- making a distribution that is abnormal as to timing and amount, without the prior written approval of the Panel and the approval of shareholders. The Act does allow companies to honour pre-existing obligations.

**Favourable conditions**

An offeror may not enter into arrangements with shareholders in the target company if there are favourable conditions attached which are not being extended to all of the offeree shareholders.

**Conclusion**

The impact of the Act on the implementation of fundamental transactions will be significant and is already being felt in relation to transactions which are commencing now but will not be implemented until after the Act has become effective.

While a number of the Act’s provisions have improved the regulation of fundamental transactions, the Act has inevitably created uncertainty in the minds of transacting parties and their advisers as a result of the introduction of new concepts, new requirements, new remedies and new time periods.

The overall objective of these innovations is laudable in that the Act seeks to improve on the old Act’s facilitation of transactions while offering greater protection to stakeholders. It is to be hoped that, as the Act’s meaning is tested and its concepts are developed and become familiar, the manner in which the Act balances these objectives proves to be appropriate and practical.
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