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CORPORATE & COMMERCIAL ALERT

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SECTION 164 COMPANIES ACT: A GUIDE FOR NAVIGATING THE TREACHEROUS TERRAIN OF S164 IN THE ERA OF SHAREHOLDER ACTIVISM AND OPPORTUNISM

It's no secret that 2018 was a difficult year for investors on the JSE. The JSE All-Share Index lost around 15% of its value during 2018, cementing the worst five-year period for the JSE in 50 years. Even some of the "blue-chips" of the market, which traditionally could be relied upon in preserving capital, were among the notable losers in 2018, with some shedding more than 50% of their market capitalisation.

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SECTION 164 COMPANIES ACT: A GUIDE FOR NAVIGATING THE TREACHEROUS TERRAIN OF S164 IN THE ERA OF SHAREHOLDER ACTIVISM AND OPPORTUNISM

We have seen a number of trends on the back of the uncertainty in the market

Relatively low valuations on the JSE has created opportunity not only for public to private transactions but also for a new breed of "value investor".



It's no secret that 2018 was a difficult year for investors on the JSE. The JSE All-Share Index lost around 15% of its value during 2018, cementing the worst five-year period for the JSE in 50 years. Even some of the "blue-chips" of the market, which traditionally could be relied upon in preserving capital, were among the notable losers in 2018, with some shedding more than 50% of their market capitalisation.

In practice, we have seen a number of trends on the back of the uncertainty in the market, including a rise in shareholder activism, a tightening-up by regulators (including the JSE and the Takeover Regulation Panel) and the apparent emergence of US-style "short and distort" campaigns. Relatively low valuations on the JSE has created opportunity not only for public to private transactions but also for a new breed of "value investor".

Value investing, made famous by Warren Buffet, is an investment strategy where long-term investors actively seek out the shares they believe the market has undervalued (as against their intrinsic, or book, value). Value investors use this strategy to buy shares when they believe the market undervalues them, and often take advantage of overreactions in the market to bad news causing stock price movements which do not reflect a company's long-term fundamentals.

Value investing is traditionally a long-term project, where the (ostensibly) undervalued shares must be held by the investor until the intrinsic value is recognised by the market. This strategy is sometimes frustrated when corporate action (often a take-over or public to private transaction) is proposed at a price below intrinsic value. The minority protection provided to shareholders by s164 of the Companies Act, No 71 of 2008 (Companies Act) provides some protection to dissenting value investors. However, it also creates an arbitrage mechanism for more opportunistic "value" investors, who are thereby able to short-circuit the traditionally long-term process.

Section 164 of the Companies Act, containing the so-called "appraisal rights" remedy, affords a shareholder, in specific circumstances (mostly major corporate actions), the right to demand that the company buy back all shares held by that



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shareholder in the company and pay the shareholder the "fair value" of those shares as opposed to the value placed thereon for purposes of the corporate action (which is typically at a premium to the market value thereof). This means that a shareholder may have an opportunity to profit should the fair value of the shares be shown to exceed the value placed thereon for purposes of the corporate action.

We have encountered a number of instances in recent years where an investor has acquired shares in a company after a take-over or corporate action was announced, only to then object to the transaction and, after the majority of shareholders have approved the deal, to then exercise her appraisal rights in order to hopefully extract a higher price. While this may be frowned upon by some, it is a lawful practice which is in fact fairly widespread in the US.

Section 164 is long, mechanical and, in our experience, compliance with the provisions of s164 can prove tricky. Our courts have, in recent years, heard numerous disputes regarding s164. Apart from being mindful of the risk of litigation, given that s164 was introduced in the Companies Act as a minority protection, companies should generally ensure that shareholders are able to utilise their appraisal rights in the manner the Companies Act contemplates, and are fully informed of their rights.

It is therefore important that, when a shareholder triggers her appraisal rights, the company properly applies the provisions of s164 and ensures full compliance therewith.

The following summary may be regarded as a blueprint of the mechanics of s164.

When are the appraisal rights under s164 available to a shareholder?

Section 164 is available when:

- the shareholders of a Company (Company) approve a resolution (the Applicable Resolution) to:
 - amend the Company's memorandum of incorporation by altering preferences, rights, limitations or other terms of any class of shares which will have a materially adverse effect to the rights or interests of the holders of that class of shares; or
 - enter into a transaction in terms of s112 of the Companies Act (proposals to dispose of all or greater part of the assets or undertaking of the Company), s113 of the Companies Act (proposals for amalgamation or merger), or s114 of the Companies Act (proposals for scheme of arrangement); and

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The board of the Company is required to determine the fair value of the shares in question at the time the Applicable Resolution was approved.



- the shareholder (the Dissenting Shareholder) has:
 - before the Applicable Resolution has been voted on, submitted a written notice to the company objecting to the resolution;
 - voted against the adoption of the Applicable Resolution; and
 - the Applicable Resolution has been approved by the shareholders.

Comment: From the Company's perspective, the first formal step that will alert the Company to the possibility that a shareholder may trigger her appraisal rights will be the receipt by the Company of a written notice from the shareholder in terms of s164(3). In this notice, the shareholder must state that she objects to the Applicable Resolution.

When are the Dissenting Shareholder's appraisal rights triggered?

Once the shareholders have approved the Applicable Resolution, the next steps are as follows:

- within **10 business days** after the Applicable Resolution has been adopted, the Company must send a notice to the Dissenting Shareholder informing her that the Applicable Resolution was passed (Resolution Notice);
- within **20 business days** after the Dissenting Shareholder receives the Resolution Notice (or if no Resolution Notice was delivered, the day she becomes aware that the Applicable Resolution was adopted) if she wishes to utilise her appraisal rights, the Dissenting Shareholder must submit a written notice to the Company demanding that the Company repurchase her shares in the Company and that the Company pay her the fair value of those shares (the Demand) and a copy of this demand must be delivered to the Takeover Regulation Panel;
- provided that the Dissenting Shareholder makes the Demand, the Company is obliged to submit a written offer to the Dissenting Shareholder to buy back her shares for fair value (the Offer), by no later than **five business days** after the later of:
 - the day on which the action approved by the Applicable Resolution is effective;
 - the last day on which a Demand may be submitted to the Company; and
 - the day on which the Company received the Demand (if the Company failed to notify the Dissenting Shareholder that the Applicable Resolution was approved),



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The board of the Company is required to determine the fair value of the shares in question at the time the Applicable Resolution was approved.



and such Offer is required to include:

- the amount considered by the board of the Company to be the fair value of the Dissenting Shareholder's shares; and
- a statement showing how that amount was determined.

Comment: the board of the Company is required to determine the fair value of the shares in question at the time the Applicable Resolution was approved. The Offer must be commensurate with this determination.

When does a Dissenting Shareholder have recourse to the courts

- If the Dissenting Shareholder finds the terms of the Offer to be inadequate, she may within **30 business days** of the Offer being made apply to court to determine the fair value of the shares and (if appropriate) order that the fair value so determined be paid by the Company.

- Should the Company fail to make the Offer, the Dissenting Shareholder is entitled to apply to court for an order compelling the Company to make the offer in accordance with s164.

Comment: The Companies Act does not provide any guidance as to how the fair value of the shares should be determined. There is a wide range of possible valuation methodologies and different methodologies may yield differing results. Also, what is appropriate in one case may not be appropriate in another. Given that the appraisal rights remedy is relatively new to South African company law, no significant body of South African case law has been developed to serve as a guide to determining the fair value of shares. Some jurisprudence has been developed in comparable jurisdictions (notably the US), and our courts would be entitled to take that into account.

2018 1ST BY M&A DEAL FLOW FOR THE 10TH YEAR IN A ROW.

2018

1st by M&A Deal Flow.
1st by M&A Deal Value.
2nd by General Corporate Finance Deal Flow.
1st by BEE M&A Deal Value.
2nd by BEE M&A Deal Flow.
Lead legal advisers on the Private Equity Deal of the Year.

2017

2nd by M&A Deal Value.
1st by General Corporate Finance Deal Flow for the 6th time in 7 years.
1st by General Corporate Finance Deal Value.
2nd by M&A Deal Flow and Deal Value (Africa, excluding South Africa).
2nd by BEE Deal Flow and Deal Value.

2016

1st by M&A Deal Flow.
1st by General Corporate Finance Deal Flow.
2nd by M&A Deal Value.
3rd by General Corporate Finance Deal Value.

2015

1st by M&A Deal Flow.
1st by General Corporate Finance Deal Flow.

DealMakers

2014

1st by M&A Deal Flow.
1st by M&A Deal Value.
1st by General Corporate Finance Deal Flow.

2013

1st by M&A Deal Flow.
1st by M&A Deal Value.
1st by Unlisted Deals - Deal Flow.

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PROCEDURAL STEPS	PARTY RESPONSIBLE	TIME PERIOD
Written notice to be sent to shareholders informing them of the date and time of the meeting (the Meeting) at which the Applicable Resolution is to be voted on (with a statement informing them of appraisal rights attached).	Company	15 business days before the meeting in the case of a public or non-profit company and 10 business days in all other instances (unless the Company's MOI requires a longer notice period to be given).
Written notice of objection to the Applicable Resolution.	Dissenting Shareholder	Prior to the Applicable Resolution being voted on at the Meeting.
Vote against the Applicable Resolution.	Dissenting Shareholder	On the date of the Meeting (Applicable Resolution proposed for adoption at the Meeting).
Deliver Resolution Notice to Dissenting Shareholder (informing the Dissenting Shareholder that the Applicable Resolution was adopted).	Company	Within 10 business days after the Applicable Resolution is adopted by the Company at the Meeting.
Deliver written Demand to the Company <i>(Note: a copy thereof must also be delivered to TRP)</i>	Dissenting Shareholder	Within 20 business days after (i) the Dissenting Shareholder received the Resolution Notice or (ii) the Dissenting Shareholder became aware the Applicable Resolution was adopted (if no Resolution Notice sent).
Company makes offer to purchase the shares from the Dissenting Shareholder.	Company	Within five business days of the later of (i) the action approved by the Applicable Resolution becoming effective, (ii) the 20 business day-period from receipt of the Resolution Notice by the Dissenting Shareholder (if applicable) and (iii) the end of the 20 business day-period from the Dissenting Shareholder learning that the Applicable Resolution was adopted by the Company.
Dissenting Shareholder accepts the Offer made to Dissenting Shareholder to purchase Dissenting Shareholder Shares or applies to court to determine fair value of Dissenting Shareholder Shares. <i>Note: if the Company fails to make the Offer, the Dissenting Shareholder is entitled to approach the courts for an order compelling the board of the Company to make an Offer.</i>	Dissenting Shareholder	Within 30 business days of the Offer being made, failing which the Offer lapses.
urchase consideration for the Dissenting Shareholder Shares paid to the Dissenting Shareholder.	Company	Within a period of 10 business days after the Dissenting Shareholder (i) delivers the applicable share certificates or (ii) taking the required steps to transfer the dematerialised Dissenting Shareholder Shares.

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The appraisal rights remedy is relatively new to South African company law, but in its short period of applicability it has received significant attention in the courts.



In practice, transactions which trigger appraisal rights are usually subject to a contractual condition precedent that appraisal rights must not be exercised in respect of more than a specified (fairly low) percentage of the shares. This a mechanism ensures that if the transaction is implemented having received the required 75% shareholder approval for the transaction, the Company is not subsequently burdened by an unacceptably high financial obligation resulting from the exercise of appraisal rights.

Contested issues relating to s164

As mentioned, the appraisal rights remedy is relatively new to South African company law, but in its short period of applicability it has received significant attention in the courts. Some of prominent cases are:

- In the case of *Loest v Gendac and Another 2017 (4) SA 187 (GP)*, a dissenting shareholder wished to rely on his status as a shareholder to request company information for the purpose of determining the fair value of the applicant's shares in terms of the Promotion of Access to Information Act (PAIA). The court found that:
 - while the applicant was not precluded from pursuing remedies under PAIA as a result of triggering the applicability of s164 of the Act, that s164 of the Act has built-in mechanisms for determining the fair value of the shares and using the PAIA was therefore inappropriate; and

- section 164(9), which provides that while a Demand remains effective the Dissenting Shareholder has no further rights in respect of those shares other than to be paid their fair value, does not mean that the shareholder loses her status as a shareholder altogether. Rather the effect of s164(9) is to remove other trappings and privileges associated with being a shareholder while she exercises her appraisal rights.

- In *Juspoint Nominees (Pty) Ltd v Sovereign Food Investments Limited (BNS Nominees (Pty) Ltd), Trustees for the Time Being of the Cilliers Family Trust, Cilliers, Cilliers Intervening Parties) 2016 JDR 0773 (ECP)*, the court held that, should the resolution which triggered the appraisal rights be revoked or lapse after having been approved, all rights of the dissenting shareholder are immediately reinstated, provided that she has not accepted the offer to have her shares repurchased by the Company.
- In *Cilliers v LA Concorde Holdings Limited and Others (23029/2016) [2018] ZAWCHC 68; 2018 (6) SA 97 (WCC) (14 June 2018) (Cilliers case)*, the respondent's wholly-owned subsidiary intended to dispose of all or a greater part of the assets. The court applied a look-through, meaning that even though it was the respondent's subsidiary that was implementing the disposal (and not the respondent itself), shareholders of the respondent were entitled to use the remedies provided under s164.

Dane Kruger and Peter Hesseling

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