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Does the market sometimes not know best? Determining the “*fair value*” of publicly traded shares when a dissenting shareholder exercises its appraisal rights

In line with international trends, it is now commonplace for South African companies wishing to undertake major corporate actions to have to contend with minority shareholders seeking to exercise their appraisal rights. The so-called appraisal remedy, provided for in section 164 of the Companies Act 71 of 2008 (Companies Act), affords a shareholder, in certain circumstances (primarily major corporate actions), the entitlement to demand that the company buy back all shares held by that shareholder in the company for the “*fair value*” thereof.



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In line with international trends, it is now commonplace for South African companies wishing to undertake major corporate actions to have to contend with minority shareholders seeking to exercise their appraisal rights. The so-called appraisal remedy, provided for in section 164 of the Companies Act 71 of 2008 (Companies Act), affords a shareholder, in certain circumstances (primarily major corporate actions), the entitlement to demand that the company buy back all shares held by that shareholder in the company for the “fair value” thereof.

In practice, this remedy is frequently invoked opportunistically by investors seeking to create an arbitrage between the offer price for the shares under a proposed transaction and the “fair value” of such shares.

The appraisal remedy is available to dissenting shareholders who vote against (i) the entering into of a merger or scheme of arrangement, or the sale of all or a greater part of a company’s assets or undertaking; or (ii) amendments to a company’s Memorandum of Incorporation that alter the preferences, rights, limitations or other terms of any class of shares which will have a materially adverse effect on the rights or interests of the holders of that class of shares. There are certain strict, procedural steps that a dissenting shareholder needs to follow to duly exercise their rights, [which we have discussed previously](#).

Where a dissenting shareholder has duly exercised their appraisal rights, a company is, within a prescribed period, required to make a formal written offer to acquire the shares held by the dissenting shareholder for an amount considered by the company’s directors to be the fair value of the relevant shares, determined as at the date on which, and time immediately before, the applicable resolution of shareholders that triggers the availability of the appraisal remedy is adopted.

FAIR VALUE VERSUS MARKET VALUE

In the context of shares traded on a free and open market, the question of whether the fair value of a share is not simply the market value thereof often arises. As the Companies Act offers no guidance in respect of determining fair value, this has been left to the courts to decide, and the recent case of *BNS Nominees (RF) (Proprietary) Limited and Another v Zeder Investment Limited and Others* (Zeder) has finally provided some guidance in this regard.

In *Zeder*, the court held that “fair value” refers to “what the shares are actually worth” and should not be equated to the market value of the shares in question. “Whilst the JSE listed price might be a good indicator of what the shares are worth, it is not the only relevant indicator”, the court held, pointing to the fact that the Companies Act does not contain a “market-out” exception – a proviso to appraisal rights in certain US states, which, with varying specifics, denies shareholders of publicly traded companies the appraisal remedy in circumstances where similarly-situated private company shareholders would be entitled to such remedy. Rather, section 164 requires the exercise of a value judgement in determining fair value, which takes all relevant circumstances into account, the court in *Zeder* held, including:

- the trading price of the shares immediately prior to the adoption of the applicable resolution;

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- the history behind the adoption of the aforementioned resolution;
- the opinions regarding the value of the shares expressed by relevant expert(s) engaged by the parties and/or an appraiser appointed by the court; and
- any other circumstances which the court might find to be relevant given the facts of the matter at hand.

Thus, while the traded market price of a listed share is a very significant consideration and will, in our view, generally be the primary reference point in considering what the fair value is – particularly where the stock market is liquid and reliable at the time of the applicable vote – it is not dispositive of the question.

NO ONE-SIZE-FITS-ALL APPROACH

How, then, should a board determine what the fair value of its company's shares is? The court in *Zeder* found that “a wide range of possible valuation methodologies exist, and different methodologies may yield differing results ... Moreover, a valuation methodology which is appropriate in one case may not be appropriate in another”. There is thus not a one-size-fits-all approach to determining fair value, and what is appropriate will depend on the nature of the business in question, amongst other relevant facts and circumstances peculiar to the valuation at hand.

Although the court in *Zeder* has not, at this juncture (pending the report of an independent court-appointed appraiser), expressed a view on which valuation methodology is the most suitable in the circumstances

of that case, which involves an investment holding company, it indicated a willingness to be guided by the approach followed in foreign jurisdictions. In Delaware in the US, which has the most richly developed jurisprudence on determining the fair value of shares, the discounted cash flow (DCF) method is most frequently used by the courts. It is not, however, the only valuation technique used, and the choice of methodology is usually dictated by the nature of the business in question and/or the context of the sale.

Accordingly, while *Zeder* has provided companies with a useful conceptual framework to reference when faced with having to make an offer to a dissenting shareholder that has duly exercised its appraisal rights, it is evident that what constitutes fair value for purposes of such an offer will turn on the facts and circumstances in question. Issuers are therefore well advised to seek guidance from their professional advisors when faced with making such an offer.

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Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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