Merger and takeover law

Impact on private companies

By Basil Mashabane

This is a follow-up to the article 'Mergers and takeovers under the new Companies Act' (2011 (Sept) *DR* 30) where I discussed the fact that South African mergers and acquisitions are experiencing a paradigm shift following the enactment and implementation of the new Companies Act 71 of 2008 (the Act) on 1 May 2011, replacing the old order.

The Act has been in existence almost three years and it has already brought enormous changes to the way mergers and takeovers are regulated in South Africa. There is no denying, however, that there exists a number of uncertainties on a few issues pertaining to the Act and its application to mergers and takeovers.

Application of mergers and takeover laws on private companies

The main subject of this article is one of the major changes that the law has introduced that has caused some consternation in business but, at the same time, appears to be enjoying support among the stakeholders it is meant to protect, namely the minority shareholders in companies. The change relates to the application of the Act and the takeover regulations to private companies registered under South African law.

The merger and takeover provisions of the Act apply to regulated companies only and s 118(1) of the Act lists and defines three types of regulated companies, namely –
• public companies (listed or unlisted);
• state-owned companies (unless exemp-ted); and
• private companies.

Under s 118(1)(*c*) of the Act a private company is regulated only if –
'(i) the percentage of the issued securities of the company that have been transferred, other than by transfer between or among related or inter-related persons, within the period of 24 months immediately before the date of a particular affected transaction or offer exceeds the prescribed percentage in terms of subsection (2) or;
(ii) the Memorandum of Incorporation of that company expressly provides that the company and its securities are subject to this Part, Part C and the Takeover Regulations, irrespective of whether the company falls within the criteria set out in subparagraph (i).'

For a private company to be regarded as regulated, certain steps must have taken place and this stems from the realisation that private companies are by nature, small and tightly held business entities and, to a large degree family controlled, making it easy for the parties to reach agreement on major issues relating to the company and its business, such as acquisitions and/or transfer of the business of the company.

Rationale for the application of the Act to private companies

It could be argued that the Act therefore envisages that a private company, which is regulated, would be a large company with a sizeable number of shareholders and with sizeable corporate activity taking place, including entering into buying and selling of shares, business transactions or other corporate activity events necessitating the involvement and/or intervention of a regulator such as the Takeover Regulation Panel to ensure that the rights of the company's minority shareholders are protected.

What is clear however, is that the majority of the matters involving private companies that the Takeover Regulation Panel (the panel) deals with involve fairly small private companies in which shareholders range between two and ten in number. These shareholders are usually party to the sale of shares or disposal of assets agreements being entered into and would proceed with these agreements unhindered, except when a private company entered into a transaction in the past 24 months in which shares exchanged hands, resulting in it being regulated and therefore required to comply with certain statutory requirements before concluding and implementing the particular sale of shares or disposal of assets agreement with another party.

These statutory requirements that a private regulated company is required to meet include the preparation of a circular in terms of the regulations with the purpose of fully explaining and disclosing to shareholders all the aspects of the merger or takeover transaction or agreement that the company is involved in and to also prepare an independent expert report (at its expense) for a valuation of the company's shares or assets in order to determine, for the benefit of the shareholders, whether the offer to acquire the shares or to effect the disposal of the company' assets, is fair or unfair to the shareholders of the company.

An argument could be made that the only rationale for regulating mergers and takeover transactions involving private companies is to protect shareholders regardless of the number of shareholders that are involved and whether or not the shareholders are fully in support of the merger or takeover transaction.

The question therefore becomes whether it is proper and rational for these provisions to exist, taking into account the nature of private companies and the transactions regulated by South African merger and takeover law.

Exemption of private companies

In recognition of what could at times appear to be an absurdity, the drafters of the Act and the regulations had the foresight to include a provision in the Act to the effect that the panel has powers to grant an exemption to an offerer to an affected transaction to an extent that doing so is not prejudicial to the interest of any party to the transaction; that the cost of compliance is disproportionate to the value of the transaction or that doing so (ie, granting the exemption) would be both reasonable and justifiable.

Based on the nature of private companies and the type of transaction entered into by these companies, the panel continues to be inundated with applications for exemptions from legal practitioners acting for these companies requesting that the parties involved in these transactions be exempted from compliance with the provisions of the Act and the takeover regulations.

The fact that the panel is, under certain circumstances, allowed to provide an exemption from its requirements should not create the impression that the panel has become a rubber stamp and fortuitously grants exemptions to parties involved in transactions with these regulated companies, particularly where, at face value, it appears that granting an exemption would be correct thing to do.

This is certainly not the case when one considers that the panel would still require a letter from the parties applying for the exemption detailing the nature of the transaction, explaining the basis on which the company is regulated, taking into account s 118(1)(*c*), together with a motivation as to why an exemption should be granted based on the factors indicated above, which are found in s 119(6), and with supporting documents including written agreements attached.

In addition to these requirements, the offerer and the party applying for the exemption would also be required to attach waiver letters from shareholders in the regulated company in which the shareholders indicate that they are aware of the offerer's obligations to comply with the provisions of the Act and the takeover regulations on mergers and takeovers, but that they are prepared to allow the offerer to obtain an exemption through them waiving their rights.

Lastly, the waiver letters must be signed in original form by all the shareholders in the regulated company in order for the application to be considered.

Conclusion

There is a prevailing argument in some quarters that the application of the Act and the regulations to private companies is cumbersome and to some extent unnecessary, taking into account the nature of the majority of private companies registered in South Africa. However, there is a counter-argument that the provisions apply to select private companies meeting certain requirements as prescribed only and it is indeed in these companies where such application of the requirements would be necessary.

Further, and in support of the counter-argument that the Act and the regulations do provide an 'escape clause' in terms of s 119(6) wherein the requirements for applying for and obtaining an exemption are all encompassing and not difficult to satisfy if and when adhered to and, lastly, that the panel has not abrogated its role and still ensures that it plays its regulatory role and function with the same amount of interest and close inspection as it would when it deals with a major takeover transaction for purposes of ensuring that the interests of shareholders are protected.

It should never be taken for granted that a large number of small businesses in South Africa have been incorporated as private companies and most of them acquire their legal services from small and medium-sized law firms.

It has been my experience over the years at the panel that practitioners in these firms hardly get exposure to merger and takeover law work and these changes to the law will inadvertently ensure that these practitioners are exposed to the world of mergers and acquisitions as they provide advice to their clients, albeit that these changes were not motivated by the desire to create more work for practitioners but to simplify the law and to also enhance shareholder protection.

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