

Companies and Deals 

Appraisal rights: Fair value, fair rule, unfair fight

Minority shareholders shouldn't have to resort to legal action to get a company to buy back their shares at 'fair value' if it implements a significant transaction they oppose.

By Ann Crotty 10 Feb 2021 00:01

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A recent court ruling takes some of the subjectivity out of the question of what can be deemed fair value.

Image: Moneyweb

Appraisal rights enable a shareholder to demand that the company buy back all their shares at 'fair value'.

In four out of four cases brought before South African courts, the judge has ruled in favour of the minority shareholders seeking to enforce their appraisal rights. In each case, a relatively under-resourced party had to endure a long and costly legal battle to secure those rights against the unlimited resources available to corporate executives and the controlling shareholders.

In handing down judgment last week in the most recent case – between fintech company Capital Appreciation (Capprec) and Rozendal Partners – Judge Leonie Windell of the Gauteng High Court reminded corporate South Africa that the appraisal remedy “is aimed at maintaining the equilibrium between minority shareholders and controlling shareholders”.

Capprec has indicated that it will appeal, but for now Windell’s ruling goes some way to reaffirming that equilibrium.

Appraisal rights, which made their first appearance in the 2008 Companies Act, enable a shareholder to demand that the company buy back all their shares at ‘fair value’ if the company implements a significant transaction that the shareholder opposes.

A wretched process

To date this right, contained in Section 164 of the Companies Act, has been little used.

This is mainly because triggering it involves an extremely tedious process that has become wretchedly legalistic and costly as companies try desperately to discourage its use.

It also means taking on the corporate establishment – the Capprec board reads like a who’s who of the top corporate personalities of the past 20 years, ditto for its law firm ENS.

Inevitably only the most determined have had the nerve to assert their rights against this sort of formidable opponent.

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Following the latest ruling, Adam Pike – senior partner at Pike Law, a specialist corporate and commercial law firm based in Cape Town – has urged companies involved in significant transactions to be more circumspect in their dealings with minority shareholders.

In particular, says Pike: “When they’re obliged to make an offer to buy out minority shareholders, they must make a proper one.”

He also cautions them to be aware of the wide array of transactions – major disposals, mergers, schemes of arrangement, specific share buybacks – that trigger appraisal rights.

As Pike sees it, appraisal cases are inevitably motivated by the belief that the value being offered to the minority shareholder is significantly below the ‘fair value’ of the share.

Pike should know – his firm has been involved in every appraisal case that has gone to court; more than anyone he has helped to create precedence about this relatively new concept. Significantly, his firm has been on the winning side in every one of those cases, despite being up against the largest and oldest law firms in the country.

In addition to the four cases on which the courts have ruled, two further matters have been resolved out of court and three are pending.

Clarity ... and the big question

The fourth and most recent of these appraisal rulings left no doubt that JSE-listed Capprec could not avoid the consequences of the share buyback it had implemented and was obliged to pay investment management firm Rozendal Partners 'fair value' for its 18.8 million Capprec shares.

But therein lies the challenge – how to determine 'fair value'?

Anyone who thinks this involves little more than a detailed scientific/accounting exercise should avoid appraisal cases.

It turns out 'fair value' is a remarkably imprecise concept – more art than science.

Paul Whitburn, analyst and portfolio manager at Rozendal Partners, explains to Moneyweb that it was unhappy about the proposed specific buyback of shares from one of Capprec's founding shareholders and decided to trigger its appraisal rights and exit the company.

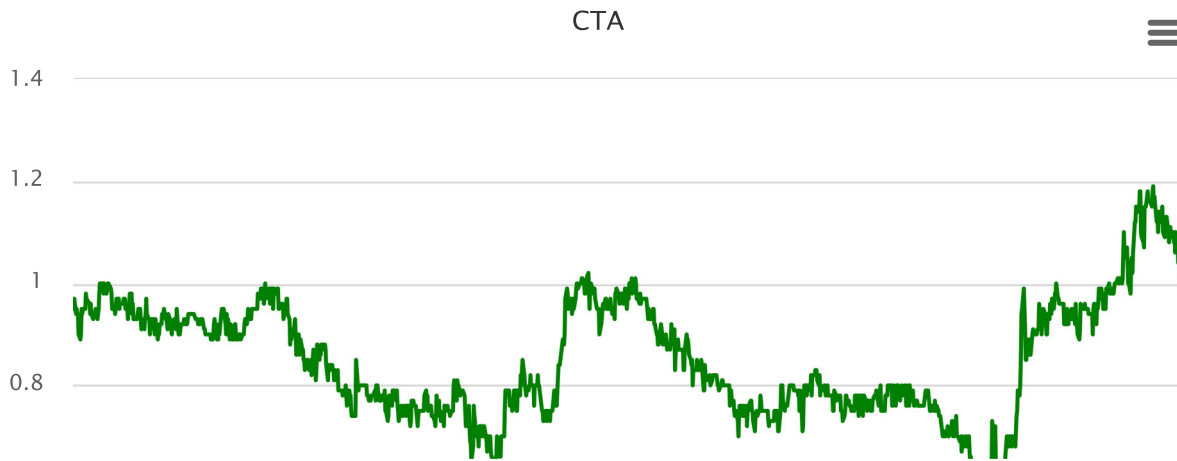
It seemed straightforward enough, given that page 2 of the July 2019 circular informing shareholders of the planned buyback reminded any dissenting shareholders of the action they needed to take if they wanted to exercise their appraisal rights.

Tension

However when Rozendal Partners informed Capprec it wanted to do just that and that it expected 'fair value' for its 18.8 million Capprec shares, things became tense as the parties argued over precisely what 'fair value' would look like.

At the time the buyback was announced the market price was 70c; in the circular, reference was made to a value of 115c a share.

Capprec share price



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Rozendal Partners believed the 'fair value' of the shares – based on valuations of global peers – was 150c a share.

Inevitably they rejected the 80c offered by Capprec, which had rather remarkably reversed its initial belief that shareholders were even entitled to appraisal rights.

Rozendal Partners' decision to go to court might have seemed inevitable. It wasn't.

There are a number of reasons why. Beyond the long drawn-out uncertainty, it is a particularly difficult choice for fund managers. Critically, fund managers are not allowed to recover expenses, such as those incurred in a lengthy legal battle, from the funds on whose behalf they've acted. This makes it a high-risk option.

In addition there's the risk, in a relatively small investment community, of alienating corporate executives who tend to balk at any sort of assertive action by minority shareholders.

Minority muscle

Whitburn says he and his partners considered the risks but notes that they are significant shareholders in the fund and had put their clients into it: "We were happy to demonstrate that we were in this with them."

He also believes appraisal rights are too powerful a mechanism not to be cultivated.

"This won't be the last time we use this right; there are many delistings ahead and we are determined to protect our investors."

Last week Windell not only confirmed that Rozendal Partners did have app down a clear process by which a 'fair value' for the shares must be determin include the appointment of an 'appraiser' who will "assist the court" in determin value'.

And while Windell, alert to the prejudice caused by ongoing delays, provided a cl the procedure, she also required Capparec to pay the dissenting shareholders int date of the 2019 transaction to whenever the final payment of 'fair value' occurs