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NEW JSE RULES ON HYBRID FINANCIAL INSTRUMENTS

With effect from 2 January 2014, a new s20 has been inserted in the Johannesburg Stock Exchange (JSE) Listings Requirements which governs so-called "hybrid financial instruments" (HFIs) that are listed on the securities exchange operated by the JSE.

HFIs are instruments which have characteristics of both debt and equity. Typical examples of debt instruments would be debentures, bonds and notes, and typical equity instruments would be ordinary shares. Various factors and tests have been adopted to distinguish debt and equity, often in the context of tax law as the classification of an instrument as one or the other often has important fiscal consequences. For instance in the 2012 US case of *Hewlett-Packard Co v Commissioner* (139 T.C. 8 (2012)), the court outlined the following key factors, amongst others:

- The presence or absence of a maturity date on an instrument;
- The source of the payments;
- The right of the holder of the instrument to enforce payment;
- The right to participate in management;
- The status / ranking of the instrument as compared to regular corporate creditors of the company; and
- The intent of the parties to the instrument (ie issuer and holder).

In March 2011, new stand-alone rules for pure debt instruments were introduced by the JSE in its Debt Listings Requirements. Subsequently a number of companies have sought advice from the JSE on how to classify certain instruments that straddle the line between debt and equity. This has led to the new rules on HFIs.

The new s20 of the Listings Requirements defines HFIs as "securities that portray characteristics of both debt securities and equity securities". Under the JSE Listings Requirements, "equity securities" are equity shares, securities convertible into equity shares, and equity instruments. In turn, "equity share capital" is a company's issued share capital, excluding any convertible securities, equity instruments and any other securities which are regarded as debt instruments in terms of IFRS or the Companies Act, No 71 of 2008. "Equity instruments" are securities with restricted voting rights but which participate in the distribution of profits in a manner directly linked to the profitability of the company. As for "debt securities", these are defined in the Debt Listings Requirements as securities which are designated by the JSE as such from time to time, including, without limitation, debentures, debenture stock, loan stock, bonds, notes, certificates of deposit, preference shares or any other instrument creating or acknowledging indebtedness.

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In this regard it is notable that certain preference shares would be likely candidates for characterisation as HFIs, as such shares very often exhibit characteristics of both debt and equity, and accordingly companies with preference shares listed on the JSE should certainly pay particular attention to the new regime introduced by the JSE. Each case however should be analysed on its own merits.

Against the above background, the following key points arise from the new HFI requirements:

- HFIs must be freely transferable.

- An existing issuer or an applicant issuer seeking a listing of HFIs on the JSE is required to comply with and satisfy all applicable JSE Listings Requirements in addition to the provisions set out in s20.

- The criteria for the listing of new HFIs are that the JSE must be satisfied with the structure of the HFI, the pricing of the HFI must be clearly determinable, and 20% of the HFIs must be held by the public and the number of public HFI holders must be at least 50.

- The issuer is required to comply with s3 of the JSE Listings Requirements which contains various continuing obligations pertaining to, *inter alia,* financial disclosures, rights of holders of securities, shareholder spreads, director dealings and communications with holders of securities. However, the following are important exclusions in respect of HFIs:

    - S3.28: The requirement that voting rights within the same class of security are the same. Note however that if the instrument happens to be a "share" as defined in the Companies Act, s37 of that Act requires all shares in the same class to have identical rights.

    - S3.29 to 3.31: These sections contain the requirement that all securities in a class shall rank *pari passu*. Further, they contain a general pre-emptive right in favour of existing holders of equity securities where the company proposes to issue fresh equity securities for cash. These requirements will not apply in respect of HFIs.

    - S3.32 and 3.33: These provisions deal with the possibility of equity security holders waiving the abovementioned pre-emptive rights in a general meeting. Since the pre-emptive rights do not apply to HFIs in the first place, there is no need for the waiver provisions to apply.

- In the event that the issuer makes any changes that affect the terms and conditions of the HFI or the underlying guarantee of such HFI (if applicable), other than changes which are of a formal, minor or technical nature or are made to correct a manifest error or to comply with mandatory provisions of South African law, the issuer must obtain approval from the HFI holders holding not less than 66.67% of the value of a specific class of HFI. This would be in addition to, and not to the exclusion of, any other approvals required, for instance, to amend the company's memorandum of incorporation if needs be (which requires a special resolution of shareholders).

- An issuer of HFIs need not comply with the provisions of s5 of the JSE Listings Requirements regarding the methods and procedures of bringing securities to listing. However, on conversion of an HFI into listed equity securities of the issuer (if the HFI is convertible), s5 will in fact apply to such equity securities.

- The bulk of the new s20 relates to the content of the issuer's prospectus or pre-listing statement in instances where it applies to have HFIs listed on the exchange.

The new HFI requirements are no doubt an important measure taken by the JSE in fulfilling its mandate of investor protection particularly in the context of complex financial instruments. Issuers of such instruments should ensure that they are *au fait* with the new requirements and should carefully consider their compliance obligations going forward, and where exactly their instruments stand in terms of the new s20 and the Debt Listings Requirements.

Yaniv Kleitman

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LOCUS STANDI AND CORRECT FORUM IN TAKEOVER LAW

The recent Johannesburg High Court case of ***Property Promotions & Management (Pty) Ltd v Securities Regulation Panel*** [2013] ZAGPJHC 282 (15 November 2013) highlighted important principles that should be borne in mind by shareholders in the context of takeover law. The case concerned the mandatory offer provisions contained in Rule 8.1 of the previous Securities Regulation Panel (SRP) Code (now contained in s123 of the Companies Act), in particular, which shareholders can bring proceedings to complain about non-compliance with those provisions, and how. Although decided under the previous takeover regime in the Companies Act, No 61 of 1973 and the SRP Code, the principles expounded in the case are still noteworthy and relevant under the current Act.

The concept of the mandatory offer has existed for a number of years in South African company/takeover law, and it is a common provision found in other jurisdictions as well. It applies where there is a company that is regulated by the takeover laws (a so-called 'regulated company' as defined in s117 of the Companies Act). Under the previous SRP Code, all public companies were regulated as well as private companies which had more than ten beneficial shareholders and an aggregate share and loan capital of over R5 million.

Under the current takeover laws as contained in parts B and C of Chapter 5 of the Companies Act and the takeover regulations, all public companies and state-owned companies are regulated, and a private company is regulated if more than 10% of its voting securities were transferred between unrelated persons in the previous 24 months. Accordingly, all companies listed on the JSE securities exchange would be regulated, and the mandatory offer provisions would therefore apply. The basic principle of the mandatory offer is that if a person acquires shares in a regulated company which pushes it over the 'bright line' of 35% shareholding, that person must make an offer to the remaining shareholders to acquire their shares.

The *Property Promotions* case has an extensive history which involved Nedbank crossing the bright line of 35% in the listed property company Acc-Ross during March/April 2007. It did so pursuant to its role as market-maker for single stock futures in respect of Acc-Ross shares and with the intention that it would deliver the shares to the purchasers under such futures after an effluxion of time. However, the purchasers of those shares defaulted and the shares were not delivered as a result. Some three years later in 2010, a number of shareholders in Acc-Ross applied to the then Securities Regulation Panel (SRP – now the Takeover Regulation Panel or TRP) to compel Nedbank to make the mandatory offer, given that it had crossed the 35% threshold. The SRP took the view that this was an exceptional scenario in which Nedbank did not intend to take control over Acc-Ross, and accordingly it ordered that Nedbank need not make a mandatory offer in the circumstances. That order was made in August 2010. Now, a further three years later, another shareholder of Acc-Ross (who had acquired shares in Acc-Ross about 18 months after Nedbank had crossed the 35% threshold) brought an application to the High Court to review that decision of the SRP. The application faltered on the basis of the applicant's lack of *locus standi*. The High Court made two important points:

- "Existing" v "entering" shareholders: It is only those persons, who held shares in the regulated company at the time that the threshold was crossed, that are entitled to complain if a mandatory offer was not made. In the Court's words –

  "the rationale of the Rules pertaining to affected transactions are to protect 'existing' shareholders who wish to exit the company once a control change occurs. It is not designed to protect 'entering' shareholders who became such long after the affected transaction took place. A simple example will suffice. If a company has 100 shares and an offeror purchases 35 from existing shareholders, such offeror obtains control of the company. If subsequent to such change of control the company increases its share capital a thousand fold, the purchasers of shares issued as a result of such increased capital cannot be seen to demand to be treated on the same basis as the original minority shareholders who were in existence prior to the increase of the share capital. It would be manifestly unjust and inequitable to do so… It would be

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surprising if in the postulated scenario above, the SRP was to find that an affected transaction took place entitling the new shareholders to be treated and bought out with a mandatory offer by the offeror at a price a thousand fold in excess of that which it paid at the time of purchasing its controlling shareholding"

Accordingly, the court held, a late-comer cannot be treated as if it was one of the minority shareholders at the time when the control changed.

- The correct forum: If a shareholder is of the view that there was a breach of the SRP Code, the shareholder could not apply directly to the High Court to enforce compliance with the Code. It had to approach the SRP which in turn would have to bring an application to the High Court, if it deemed necessary, in order to have the breach remedied. That much was clear from the previous s440M which stated that compliance with the SRP Code had to be dealt with by and through the SRP whereas as damages could be claimed by aggrieved shareholders in the High Court.

Interestingly, the new Companies Act and takeover regulations are not that express on the second point, but the overall text and structure of the new regime strongly suggests that it is still the case that aggrieved shareholders must request the TRP to enforce parts B and C of Chapter 5 of the Companies Act and the takeover regulations, and cannot approach the High Court for such purposes. There is a body of case-law in South Africa to the effect that if a statute provides for alternative or specialised forums for the resolution of certain disputes, the plaintiff is limited to those forums and may not resort to the more general remedies of approaching the High Court, at least not as a forum of first instance. The establishment of the TRP would appear to fall squarely within that principle.

As for a claim for damages, a shareholder can approach the High Court under s218(2) which provides that if a contravention of the Companies Act results in loss or damage to a third party, that party may sue the defaulter for such loss or damage.

The nature of disputes that arise under takeover law are often such that aggrieved parties have very little time to lose in bringing appropriate proceedings to protect their interests. *Property Promotions* is an important recent pronouncement on the question of the correct forum and ensuring the necessary *locus standi*, both of which would invariably be critical considerations in this regard.

Tamarin Tosen and Yaniv Kleitman

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BANKS AMENDMENT ACT

The Banks Amendment Act, No 22 of 2013 came into force on 10 December 2013, and amends the Banks Act, No 94 of 1990 in some substantial respects.

Its primary aim is to bring South African banking regulation in line with the latest recommendations of the Basel Committee of Banking Supervision (Basel III). The bulk of the Amendment Act deals with the new capital requirements and classes of share capital required to be in issue by banks, as per Basel III – a topic which in itself brings about a number of company law issues that warrant extensive analysis and advice. Other corporate and commercial law issues that are worth noting in the Amendment Act are as follows:

- There is a general update of the Banks Act (in particular its cross-referencing to other statutes) to bring it in line with recent legislation such as the Companies Act, No 71 of 2008, Financial Markets Act, No 19 of 2012 and the Collective Investment Schemes Control Act, No 45 of 2002.

- The Amendment Act makes it clear that the business rescue provisions contained in Chapter 6 of the Companies Act shall not apply to banks. The Banks Act contains its own rescue provisions that pertain to banks.

- The power is given to the Registrar of Banks to invoke s77 of the Companies Act, which deals with the personal liability of directors and prescribed officers to their companies for breaches of the Companies Act and the company's memorandum of incorporation.

- There is an expansion of banks' audit committees' functions, to bring them in line with the Companies Act.

- There is now a statutory requirement for banks to have remuneration committees. This cements the recommendations in King III into statute.

The Banks Amendment Act is an important development in South Africa which aims at bringing our legislation further in line with global standards. Watch this space for more detailed updates and alerts on the above issues as the process of implementation of the new law goes into full swing.

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