Corporate & Commercial

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CDH INCORPORATED

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SOUTH AFRICA

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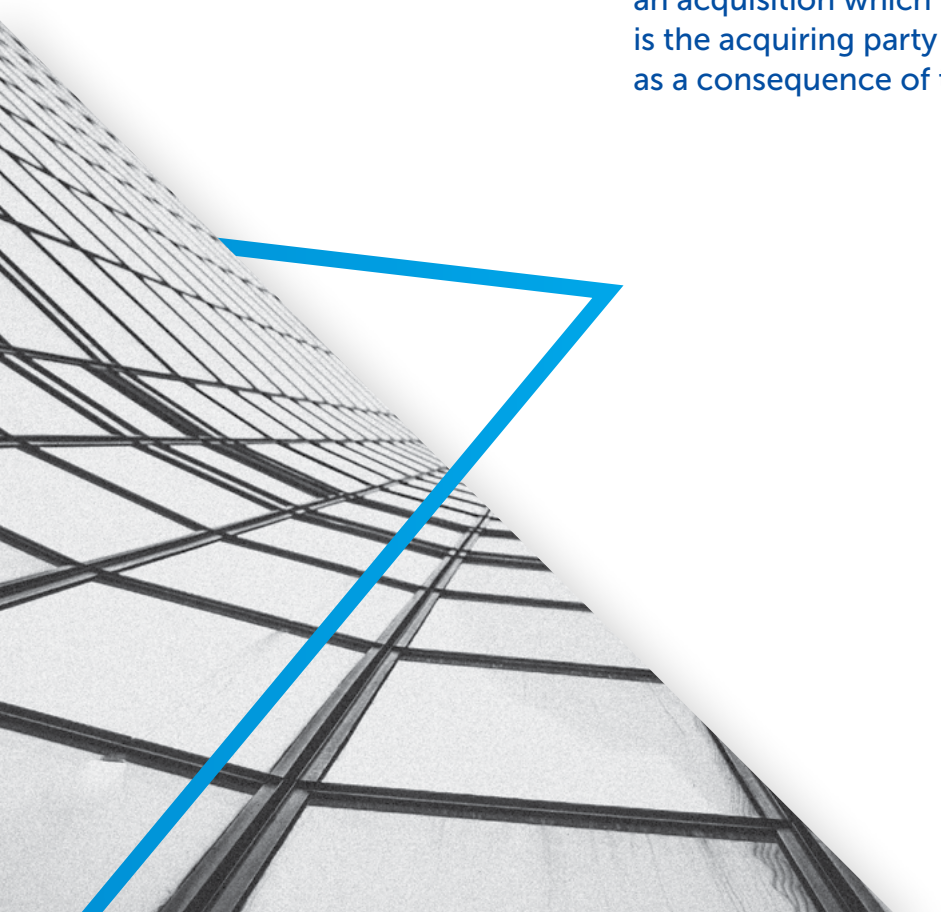
Mandatory offers in the context of bespoke limitations on voting rights

The requirement to make a mandatory offer in terms of section 123 of the Companies Act 71 of 2008 (Companies Act), is triggered by an acquisition of a beneficial interest in securities of a regulated company, as a consequence of which the acquiror (together with its related and concert parties) is able to exercise at least 35% of the voting rights attached to the securities of the regulated company. Accordingly, the principal feature of an acquisition which triggers a mandatory offer, is the acquiring party crossing the 35% bright line as a consequence of the acquisition.



The question of whether the mandatory offer requirement is triggered in circumstances where the memorandum of incorporation (MOI) of the regulated company places restrictions on the voting rights attached to the acquired shares arose in the much-publicised Multichoice Group Limited (MCG)/Groupe Canal + S.A. (Canal +) matter. In this case, the Takeover Regulation Panel (TRP) had to decide on the applicability of section 123 when Canal +'s holding of ordinary shares in MCG rose above 35% as a result of several acquisitions of MCG shares. The nuance here was that MCG's MOI provides for limitations on the voting rights that may be exercised by foreign shareholders, in order to avoid a breach of the 20% foreign control restriction in telecoms legislation.

In terms of section 123 of the Companies Act, the test for the triggering of a mandatory offer is as follows: (i) there must be an acquisition of a beneficial interest in the voting securities of a regulated company; (ii) before that acquisition, the acquirer must have **been able to exercise less than 35% of the voting rights attached to the securities of the regulated company**; and (iii) as a result of the acquisition, the acquirer is subsequently able to exercise at least 35% of the voting rights attached to the securities of the regulated company.

Mandatory offers in the context of bespoke limitations on voting rights

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Article 40 of the MOI

Canal + contended that despite it holding over 35% of the MCG shares *"on paper"*, it was not required to make a mandatory offer because, factually, it is not able to exercise 35% or more of the voting rights attached to MCG's securities due to the limitations in article 40 of MCG's MOI. Those limitations on voting rights have been included in the MOI as MCG's chosen means of ensuring its compliance with the statutory restrictions imposed by the Electronic Communications Act 36 of 2005 (ECA).

More specifically, article 40.1.1 of the MCG MOI provides, *inter alia*, that if the number of MCG shares held by foreign shareholders exceeds the *"Foreign Control Restriction"* then limitations are placed on the foreign shareholders' rights as follows:

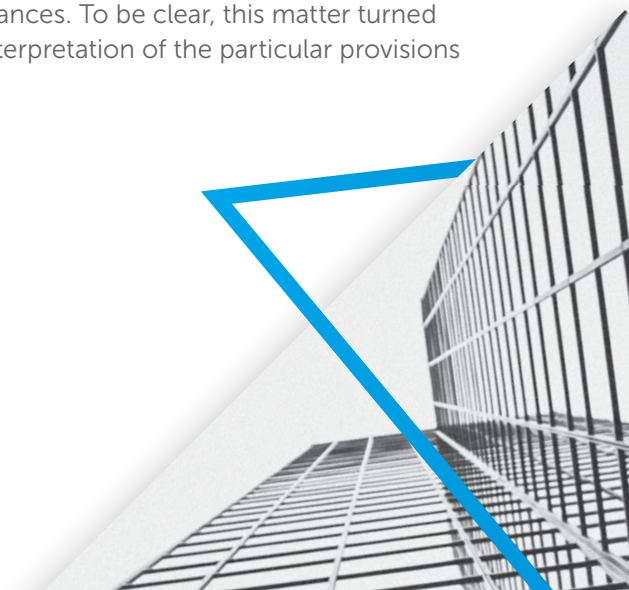
> *"... the Foreign shareholders' ability to exercise voting rights attached to each ordinary share held by such Foreign shareholders shall be limited such that (i) the ordinary shares held by Foreign shareholders do not, in aggregate, carry voting rights in excess of the Foreign Control Restriction, and (ii) the total number of voting rights cast by or on behalf of Foreign shareholders at such shareholders' meeting do not exceed the Foreign Control Restriction. In the event that the Foreign shareholders' voting rights are limited as contemplated above, then, in such circumstances only, the voting rights attached to each ordinary share held by South African shareholders shall be consequently increased proportionately in accordance with each South African shareholder's shareholding."*

"Foreign shareholders", in this case, may be loosely said to be non-South African persons, including entities controlled by non-South Africans. Furthermore, the *"Foreign Control Restriction"* is defined in article 1.1.13 of the MOI to mean:

> *"...**as set out in section 64(1) of the ECA**, the restriction and limitation placed on the ability of a foreigner to **directly or indirectly**: (i) exercise control over a holder of a commercial broadcasting service licence in terms of the ECA; and (ii) have a financial interest or an interest in voting shares or paid-up capital in a holder of a commercial broadcasting service licence in terms of the ECA, from time to time, which restriction and limitation is currently placed at 20% (twenty percent)."*

Applicable limitations

This raises an interesting debate around categorising MOI limitations as being *"inherent/intrinsic to the class rights"* versus limitations which are merely *"external"* to the shares and are applicable only to certain shareholders under certain circumstances. To be clear, this matter turned largely on the interpretation of the particular provisions



Mandatory offers in the context of bespoke limitations on voting rights

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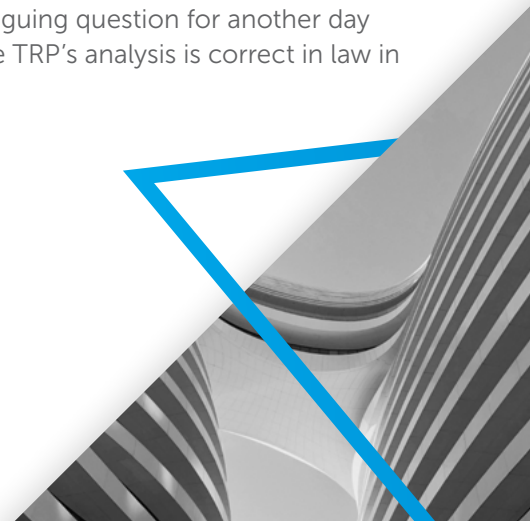
of the MOI in question. The TRP undertook a considered analysis of article 40 of the MCG MOI and took the view that it was only triggered when both the *"circumstances"* and the need to ensure compliance with the foreign control restrictions in section 64 of the ECA, are present. Therefore, in the TRP's view a blanket restriction on the part of any foreign shareholder to exercise their shares beyond the limits imposed in article 40 of the MOI, is unfounded.

The TRP noted that article 5.1 of the MOI provides that *"the Company is authorised to issue 1,000,000,000 ordinary shares of no par value, each of which* ***rank pari passu in all respects***", and section 37(2) of the Companies Act provides that each issued share of a company, regardless of its class, has associated with it one general voting right, except to the extent provided otherwise by the Companies Act or the preferences, rights, limitations and other terms determined by or in terms of the company's MOI in accordance with section 36.

The TRP's ruling

Ultimately, the TRP noted that on its reading of article 40 of the MOI, the provision does not create an intrinsic limitation in the rights attaching to the MCG ordinary shares: Each ordinary share in MCG has a general right to vote attaching to the share, except to the extent that the MCG board of directors, acting under the power envisaged in article 40, may scale back a shareholder's voting rights or power at a shareholders' meeting in circumstances contemplated in article 40 (i.e. in circumstances where the *"Foreign Control Restrictions"*, as defined, are likely to be exceeded should all shareholders (specifically foreign shareholders) be allowed to exercise their voting rights in accordance with the ordinary voting rights/powers attaching to their respective individual shares. Key to the TRP's ruling was that it was common cause that MCG had other significant *"non-ECA regulated"* businesses, other than its subsidiaries that are ICASA licensees. Therefore, despite article 40, any MCG shareholder, even a foreign shareholder such as Canal +, could in theory exercise full voting rights at shareholder meetings generally when it comes to those non-ECA businesses.

As such, the TRP held that the Canal + argument that a foreign shareholder can **never** exercise full voting rights which exceed the threshold contemplated in the foreign control restrictions, does not hold. After all, the article does not provide, in plain text, that a foreign shareholder's voting rights are restricted to 20%, but rather foreshadows this as a possibility if and when the ECA could be breached. Put another way, article 40 floats in and out of the picture depending on the subject matter of the MCG shareholders' resolution, and is not a limitation that is intrinsic to the shares. The TRP did not, however, delve into specific examples of the kinds of matters that, on its argument, would trigger the applicability of article 40 and those which would not (an intriguing question for another day perhaps, if, of course, the TRP's analysis is correct in law in the first place).



Mandatory offers in the context of bespoke limitations on voting rights

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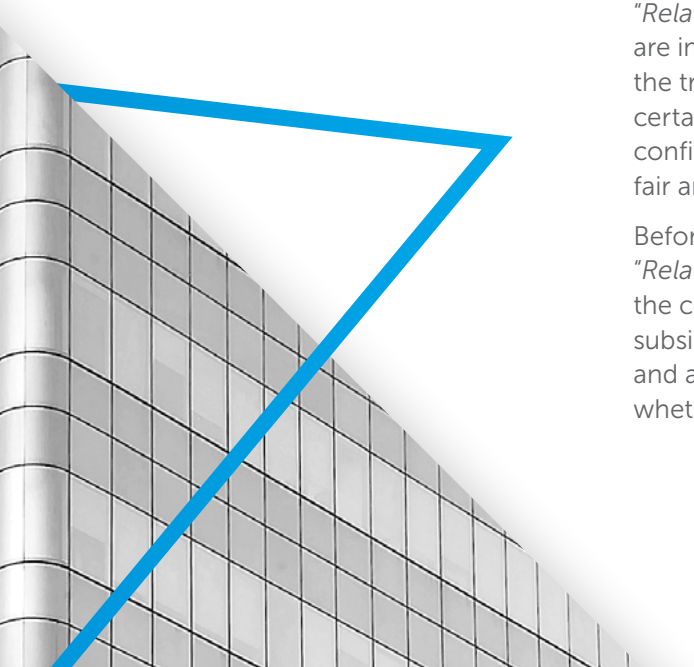
Therefore, in this case, the TRP ruled that the provisions of article 40 of the MOI did not relieve Canal + of its obligations to make a mandatory offer and, accordingly, Canal + had to take immediate action to comply with the requirements of section 123(3) and (4) of the Companies Act by making a mandatory offer to the remaining shareholders of MCG. Canal + has since done so and its mandatory offer is presently underway.

Ultimately, the MCG/Canal + scenario is quite a peculiar one as it is rare for listed companies to have such restrictions – the stock exchange's general point of departure is that all shares must rank pari passu for all purposes – unless they are, for instance, in sectors that are legislatively regulated by ownership restrictions. Furthermore, there is no doubt the TRP did not seek to make any sweeping statements in general around MOI-imposed voting limitations and their interplay with section 123. The key takeaway therefore is that where they are present in a target company's MOI, voting restrictions should be carefully considered by a would-be acquirer on a case-by-case basis to understand exactly how and when they apply, and whether they can be said to be *"absolute"* insofar as class rights are concerned. Given that the mandatory offer lies at the heart of minority shareholder protection in takeover law, a compelling case would have to be made to the TRP that a voting limitation deactivates section 123.

Jesse Prinsloo overseen by Yaniv Kleitman and Dane Kruger

Related parties under the CTSE listings requirements



The South African listed environment has significantly shifted in recent years due to the increased popularity, and viability, of newly licenced securities exchanges that provide an alternative to the JSE.

Among the newcomer exchanges that have become attractive platforms for listing is the Cape Town Stock Exchange (CTSE) (previously the 4AX).

Of the many pertinent factors to be considered when determining the most appropriate platform for a prospective listing, the listings requirements of the applicable exchange, and in particular the continuing obligations imposed on listed issuers, is a factor often not considered in detail prior to listing.

In terms of the listings requirements of the CTSE (CTSE LR), where a transaction between an issuer or its subsidiary and a counterparty falls within the ambit of the definition of a "*Related Party Transaction*", certain regulatory obligations are imposed, including the obligation to announce the transaction, obtain shareholder approval, and in certain instances provide a valuation report and written confirmation that the terms of the proposed transaction are fair and reasonable.

Before assessing whether a transaction qualifies as a "*Related Party Transaction*" it is necessary to establish if the counterparty to the transaction with an issuer or its subsidiary is a "*Related Party*" as defined in the CTSE LR, and a fundamental aspect of this enquiry is determining whether either party to the transaction controls the other.

In terms of section 1 of the CTSE LR, "*Related Party*" is defined as:

> *"Related Party" shall have the meaning ascribed in IFRS and in relation to any Issuer, shall include any entity or Person who:*
>
> *a) **Controls** or exerts **Significant Influence** over the Issuer which shall include Directors of the Issuer; or*
>
> *b) the Issuer **Controls** or exerts **Significant Influence** over,*
>
> *and, includes the Immediate Family of such Person;*

As is evident from the definition of "*Related Party*" set out above, one would essentially need to establish whether any of the following circumstances between the issuer or its subsidiary and the counterparty exists:

- a related party relationship in terms of IFRS;
- "*Control*"; or
- the exertion of "*Significant Influence*".

IFRS control and "*Control*"

In terms of IFRS (IAS 24), control is one of the circumstances that would constitute a related party relationship with a reporting entity. The principle of control is dealt with in IFRS 10 where control of an investee is defined as:

> *"An investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee."*

Related parties under the CTSE listings requirements

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The three elements of IFRS control are (i) power over the investee; (ii) exposure, or rights to variable returns from involvement with the investee; and (iii) the ability to use power over the investee to affect the amount of those returns.

An investor has power over an investee when the investor has existing rights that give it the current ability to direct the relevant activities, i.e. the activities that significantly affect the investee's return.

In comparison, the term "*Control*" as used in the definition of "*Related Party*" at paragraph (a) (Paragraph A) is not expressly defined in the CTSE LR. Notably, reference to control having the meaning given thereto in the Companies Act 71 of 2008 (Companies Act) is found elsewhere in section 1 of the CTSE LR:

- the term "*Controlling Shareholder*" is defined as any person who controls a company as contemplated in terms of section 2(2) of the Companies Act; and
- under the definition of "*Subsidiary*", the meaning given to control is the meaning in section 2(2) of the Companies Act.

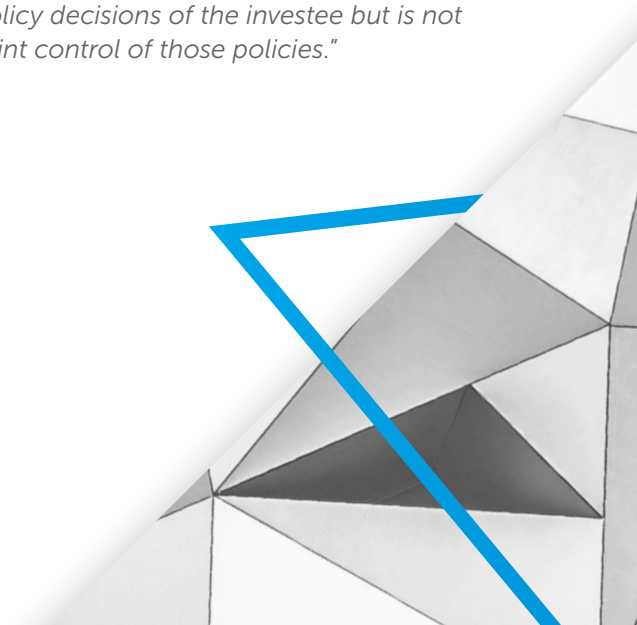
Turning to section 2(2) of the Companies Act, control of a company or its business may essentially come about where (i) one has the ability to exercise or control the majority of the voting rights associated with its securities; or (ii) one has the right to appoint or elect, or control the appointment or election of, directors who control the majority of the votes at the meeting of the board; or (iii) one has the ability to materially influence the policy of the company in a manner comparable to a person who, in ordinary commercial practice, would be able to exercise an element of control referred to in (i) or (ii).

Having regard to the relevant provisions set out above, the IFRS concept of control appears to be wider than the concept of control in terms of section 2(2) of the Companies Act. Presuming the forementioned, and that the meaning ascribed to "*Control*" under Paragraph A is the meaning given in section 2(2) of the Companies Act, raises the possibility that a relationship between an issuer or its subsidiary and a counterparty which does not amount to control under section 2(2) of the Companies Act, thereby ruling out "*Control*" under Paragraph A, may still amount to control under IFRS, resulting in a related party relationship under IFRS and consequently a "*Related Party*" relationship.

IFRS significant influence and "*Significant Influence*"

In terms of IFRS (IAS 24), significant influence is also one of the circumstances that would constitute a related party relationship with a reporting entity. The principle of significant influence is dealt with in IFRS (IAS 28) where significant influence is defined as:

> *"the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies."*



Related parties under the CTSE listings requirements

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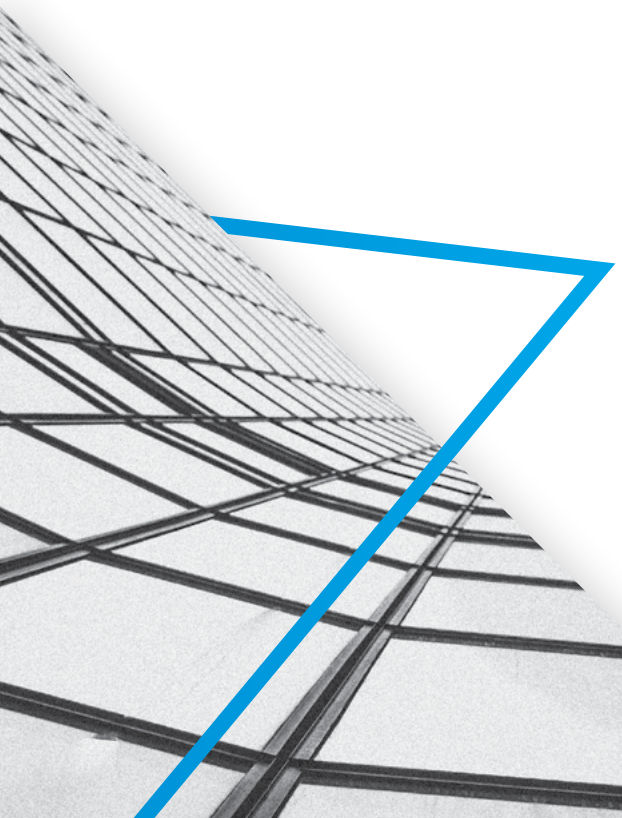
In comparison, the term "*Significant Influence*" is expressly defined in section 1 of the CTSE LR as:

> *"Significant Influence" has the meaning ascribed to such term in IFRS. Notwithstanding the definition contained in IFRS, Significant Influence shall exclude Control but shall include the power:*
>
> *a) to participate in the financial and operating policies of an entity, and/or*
>
> *b) exercisable by any shareholder holding in excess of 10% (ten percent) of the issued share capital of an Issuer or Subsidiary;*

Having regard to the relevant provisions set out above, the concept of significant influence in terms of section 1 of the CTSE LR appears to be wider than the IFRS concept of significant influence. Presuming the forementioned, and that the meaning ascribed to "*Significant Influence*" under Paragraph A is the meaning given in section 1 of the CTSE LR, raises the possibility that a relationship between an issuer or its subsidiary and a counterparty which does not amount to significant influence under IFRS, thereby ruling out a related party relationship under IFRS, may still amount to "*Significant Influence*" under Paragraph A, resulting in a "*Related Party*" relationship.

Dane Kruger and Zakiya Shaik



Chambers Global 2024 Results

Corporate & Commercial

Chambers Global 2021–2024 ranked our Corporate & Commercial practice in: **Band 1**: Corporate/M&A and in

Chambers Global 2024 ranked our Corporate & Commercial practice (Kenya) in Band 4 Corporate/M&A.

Chambers Global 2024 positioned our Private Equity sector in the "**spotlight**".

Ian Hayes ranked by Chambers Global 2022–2024 in **Band 1**: Corporate/M&A.

David Pinnock ranked by Chambers Global 2022–2024 in **Band 1**: Private Equity.

Peter Hesseling ranked by Chambers Global 2022–2023 in **Band 2**: Corporate/M&A and in **Band 3**: Capital Markets: Equity in 2023–2024.

Willem Jacobs ranked by Chambers Global 2022–2024 in Band 2: Corporate/M&A and in **Band 3**: Private Equity.

Sammy Ndolo ranked by Chambers Global 2021–2024 in **Band 4**: Corporate/M&A.

David Thompson ranked by Chambers Global 2024 in **Band 5:** Corporate/M&A.

Vivien Chaplin ranked by Chambers Global 2024 in **Band 5**: Corporate/M&A.

Chambers TOP RANKED Global 2024

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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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