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## NOTES

### ENSURING ADEQUATE FUNDING FOR THE TAKEOVERS WATCHDOG

CARIAS TERERAI CHOKUDA

*Lecturer, Department of Commercial Law, University of Cape Town*  
and

JACQUELINE YEATS

*Lecturer, Department of Commercial Law, University of Cape Town*

### INTRODUCTION

The Securities Regulation Panel (the Panel) is a regulatory body established in terms of s 440B of the Companies Act 61 of 1973 (the Act). Its function is, among other things, to regulate corporate mergers and takeovers. It is mandated to make rules relating to the effective monitoring of compliance with, and enforcement of, the Securities Regulation Code on Company Takeovers and Mergers (the Code: see ss 440C (1)(a) and (4)(e) of the Act). The Panel was formed pursuant to a report made to the Standing Advisory Committee on Company Law by the Hon Mr Justice Cecil Margo and Professor Stefan Naude in 1983 (the Margo Report: see *The Securities Regulation Code: Its Background, Implementation and the Role as Pertaining to Take-overs and Mergers*, available at <http://www.srpanel.co.za/Background.pdf>, accessed on 2 June 2008). In the report Margo J and Professor Naude did not consider it necessary to discuss the administrative and financial details of the Panel's organization because they did not foresee any insurmountable problems (see C Margo and S Naude 'Take-overs and Mergers: the City Panel and the Position in South Africa' in *Report to the Standing Advisory Committee on Company Law* (1983) 35). With the benefit of hindsight, one could say that they ought to have discussed the issue, for the Panel established as a result of their recommendation has faced, and continues to face, financial problems which threaten its continued financial viability. This in turn affects its ability both to monitor compliance with, and to enforce, the Code. In the course of events, details of the Panel's financing scheme were left to be determined by the legislature and the Panel itself.

The funding structure of the Panel (as provided for in the Companies Act read with the Code) will be examined in the discussion that follows. It will

be shown that the funding structure has some weaknesses, which have resulted in inadequate funding for the Panel. In a bid to identify improvements that could be made to the Panel's funding structure, a comparative analysis will be undertaken of the funding structures of similar regulatory bodies, namely the United Kingdom's City Panel on Take-overs and Mergers (the London Panel), and the New Zealand Takeovers Panel. Similarities as well as significant differences exist between the funding structures of these two regulatory bodies and the Panel's funding structure. On the basis of our comparative analysis, recommendations are made in this note as to how the Panel's funding structure could be improved to ensure adequate funding, and which could enhance the Panel's ability to enforce the Code.

In making the recommendations referred to above, we have taken cognisance of the changes contemplated by the new South African Companies Act 71 of 2008 (date of commencement yet to be proclaimed at the time of writing), which seeks to reconstitute the Panel as the 'Takeover Regulation Panel', this as part of a wider, more far-reaching overhaul of the Companies Act as a whole. While we shall argue that the new Act introduces some new and positive features to the Panel's funding structure, we shall indicate that the new Act also proposes to do away with some positive features of the existing Panel's funding structure. We shall argue that significant changes to the current structure are not necessary, and that the current structure needs only to be improved upon.

#### FUNDING OF THE PANEL

Funding for the Panel is provided for in Rules 2.1 and 2.2 of the administrative rules in the Code, which are to be read with s 440C(4)(a) and s 440E of the Companies Act. Section 440C(4)(a) provides that the rules (as laid down in the Code) shall make provision for the administration and financing of the Panel. Section 440E further provides that all the fees payable under the rules contemplated in s 440(4)(a) shall be paid to the Panel and shall constitute its funds, and that the Panel shall utilize its funds for defraying expenses incurred in connection with the performance of its functions.

According to rule 2.1 of the administrative rules in the Code, the Panel's funding will be partially met from a fee, which is based on a percentage of the annual listing fees and initial listing fees charged by the Stock Exchange to companies listed on that exchange. The Stock Exchange in this case is the JSE Limited (the JSE). Rule 2.2 of the administrative rules provides for another source of funding, namely a fee charged in respect of the various services provided by the Panel. In terms of the Schedule of Fees and Charges which forms part of the administrative rules, these services include, among other services, consultations, interviews, advice and examination of documents. The Panel thus has two basic sources of funding: the levy based on a percentage of the annual listing fee or the initial listing fee charged by the JSE as provided for in rule 2.1; and the fee for services provided for in rule 2.2 of the administrative rules.

It would appear that, as a source of income, the levy based on a percentage of the annual listing fees and initial listing fees charged by the JSE to companies listed on that exchange has a weakness in that it results in reduced revenues for the Panel when companies delist from the Stock Exchange and during periods when there are few or no initial public offerings on the Stock Exchange. For example, in the Panel's annual financial statement for the year ended 28 February 2003 (available at <http://www.srpanel.co.za/AFS%202003.pdf>, accessed on 2 June 2008), the Executive Director of the Panel noted that '[a] result of the shrinking number of companies maintaining their listing on the JSE . . . was that income received by way of the 4% levy charged on companies' annual listing fees fell by 18% from R1 317 347 in the previous financial year to R1 076 322'. In order to compensate for the falling revenue received from this levy, the Panel has had to increase the rate of the levy (see Securities Regulation Panel Annual Financial Statements for the year ended 28 February 2005, available at <http://www.srpanel.co.za/Annual%20Report%202005.pdf>, accessed on 2 June 2008). The result of this increase in the levy, caused by the Panel's need to break even, is that the reduced number of companies remaining on the Stock Exchange have to bear an increased burden to support the Panel.

It is apparent that the funding available to the Panel under the existing funding structure is inadequate to meet the Panel's operating needs. In 2004 the Panel incurred a budget deficit of R1.53 million due to 'falling revenues and hefty legal and enforcement costs' (see Securities Regulation Panel Annual Financial Statements for the year ended 28 February 2004, available at <http://www.srpanel.co.za/AFS%202004.pdf>, accessed on 2 June 2008). Another deficit of R1.17 million in 2005 prompted the Panel's Chairperson to say (in the Securities Regulation Panel Annual Financial Statements for the year ended 28 February 2005 loc cit):

'That is clearly an unsatisfactory position in which the Panel finds itself bearing in mind its importance to the South African economy and its financial markets. It also underlines . . . : —

- (i) the need for the Panel to be properly and adequately financed having regard *inter alia* to a statement made by one disputant that its pockets were far deeper than those of the Panel; . . .'

It is clear from this that the Panel's ability to enforce the Code against well funded corporations is undermined by inadequate funding. Despite this inadequate funding, the Panel has nevertheless managed to enforce the Code over the years, as Renée Bonochis observes (see 'SRP Gives Minority Money's Worth Despite Lame Budget' in *Business Report*, available at <http://www.busrep.co.za/index.php?fSectionId=553&fArticleId=2535857>, accessed on 2 June 2008):

'In the absence of the necessary financial resources to match the enormously well-resourced vested interests that approach it on a daily basis, the SRP [Panel] has tended to resort to a variety of tactics, including informal discussions, persuasion and ex parte rulings. This is what has helped to keep the SRP [Panel]'s regulatory process ticking over.'

However, it is submitted that inadequate funding threatens the Panel's continued financial viability, and hence its ability to enforce the Code (S M Luiz 'Enforcement of the Securities Regulation Code and the Role of the Courts' (2006) 27 *Obiter* 49). Therefore, it is necessary to find ways of ensuring adequate financing for the Panel. With this objective in mind a comparative analysis of the funding structure of the London Panel and the New Zealand Takeovers Panel will be undertaken below. The comparison between the Panel and the London Panel is appropriate given that the Code is to a large extent based on the City Code issued by the London Panel (see explanatory note 1(c) of The Securities Regulation Code on Take-Over and Mergers). On the other hand, a comparison with the Takeovers Panel in New Zealand is relevant given that the New Zealand Takeovers Panel is a statutory body like its South African counterpart (see s 5 of the New Zealand Takeovers Act 107 of 1993) and the New Zealand Takeovers Code that it enforces also has statutory force like the South African Code (see s 28(4) of the New Zealand Takeovers Act). In addition, both the London Panel and the New Zealand Takeovers Panel operate in legal systems based on the common law, like the South African Panel does. The object of the comparative exercise is to identify areas where the Panel's funding structure can be improved upon by learning from the experiences of similar regulatory bodies in these comparable jurisdictions.

#### FUNDING OF THE LONDON PANEL

Since its establishment in 1968, the London Panel, as well as the City Code which it administers, had no statutory backing (see *R v Panel on Takeovers and Mergers, Ex Parte Datafin* [1987] 1 QB 815 at 824). However, following the implementation of the European Union Directive on Takeover Bids in the United Kingdom in 2006, the London Panel was designated as the supervisory authority to carry out certain regulatory functions in relation to takeovers, and at the same time the City Code was accorded statutory force (see ss1 and 2(a) of the City Code on Takeovers and Mergers, available at <http://www.thetakeoverpanel.org.uk/new/codesars/DATA/code.pdf>, accessed on 2 June 2008). The London Panel's statutory functions are provided for in Chapter 1 of Part 28 of the United Kingdom's Companies Act, 2006. (Part 28 of the Companies Act, 2006 came into force on 6 April 2007 as per the Companies Act, 2006 (Commencement No 2 Consequential Amendments, Transitional Provisions and Savings) Order 2007 published in SI 2007/1093, available at [http://www.opsi.gov.uk/si/si2007/uksi\\_20071093\\_en.pdf](http://www.opsi.gov.uk/si/si2007/uksi_20071093_en.pdf), accessed on 2 June 2008.) It should be noted that this Act does not confer the status of a statutory body on the London Panel. It remains an unincorporated body, as constituted from time to time, and as such has rights and obligations under the common law (see Explanatory note 1181 of United Kingdom Companies Act, 2006, available at <http://www.opsi.gov.uk/acts/acts2006/en/06en46-u.htm#end>, accessed 2 June 2008). Funding for the London Panel is provided for in ss 957–9 of the Companies Act, 2006. The London Panel derives its

funding from three sources of income, namely: document charges; the PTM (Panel on Takeovers and Mergers) levy; and exempt charges (see 'Fees and Charges', available at <http://www.thetakeoverpanel.org.uk/new/>, accessed on 2 June 2008).

The funding from document charges is provided for in s 957 of the UK Companies Act, 2006 as read with s 13 of the City Code. Document charges are payable on offer documents for all offers valued at £1 million or more; the charge depends on the value of the offer according to the scale of document charges set out in the City Code (*idem*). Document charges are similar to the fees levied by the South African Panel for examining documents submitted to it for approval in terms of rule 2.2 of the administrative rules in the Code, as read with the Schedule of Fees and Charges. Thus on this count the Panel's funding structure is similar to that of the London Panel.

The PTM levy is provided for in s 958 of the UK Companies Act, 2006. Section 958(1) provides:

- 'For the purpose of meeting any part of the expenses of the [London] Panel, the Secretary of State may by regulations provide for a levy payable to the Panel —
- (a) by specified persons or bodies, or persons or bodies of a specified description, or
  - (b) on transactions, of a specified description, in securities on specified markets . . .'

On the face of it, the PTM levy appears to be similar to the levy charged by the South African Panel, which is based on a percentage of the annual listing fee or the initial listing fee charged by the Stock Exchange as provided for in rule 2.1 of the administrative rules. However, the two levies are different. The difference is fundamental in so far as the revenue potential of the two levies is concerned. As a source of revenue, the PTM levy has a much wider scope of application and hence a potentially larger revenue generation capability than the South African levy, which is payable by companies listed or listing on the Stock Exchange only. According to s 958(1) of the UK Companies Act, 2006 the PTM levy is payable by specified persons or bodies and it can also be levied on specified transactions in securities on specified markets. Currently, the PTM levy is applied to all UK securities transactions, except gilts, where the value of the deal exceeds £10 000 or €15 000 (see 'What is PTM?', available at <http://www.firstdirect.com/investments/shared dealing-rates-fees.shtml#question5>, accessed on 2 June 2008). It is thus a charge imposed on investors when they buy or sell shares the value of which exceeds £10000 (see PTM levy definition, available at <http://www.finance-glossary.com/terms/PTM-levy.htm?id=2008&ginPtrCode=00000&PopupMode=>, accessed on 2 June 2008). It is levied on transactions carried out on three securities markets: the London Stock Exchange; virt-x; and Ofex (see 'Fees and Charges' *ibid*).

Section 958(2) of the UK Companies Act, 2006 further provides that the power to specify (or specify descriptions of) persons or bodies must be exercised in such a way that the PTM levy is payable only by persons or

bodies that appear to the Secretary of State to be capable of being directly affected by the exercise of any of the functions of the Panel, or otherwise appear to have a substantial interest in the exercise of any of those functions. It will be seen from this that the PTM levy goes beyond the London Stock Exchange to cover unlisted entities and persons who are capable of being directly affected by the London Panel's exercise of its functions or have a substantial interest in the exercise of those functions. Given its wider scope of application, and the frequency and the volumes at which shares are bought and sold on the specified securities markets, the PTM levy has the potential to raise far more revenue than a levy based on the percentage of fees charged to companies listed or listing on the Stock Exchange.

The exempt charges are provided for in s 13 of the City Code. They are levied on entities such as fund managers and principal traders who are granted exemption from the application of certain provisions of the City Code: for example, a fund manager may be exempted from the application of the principle of acting in concert. The granting and continued regulation of exempt status is provided at a cost to the Panel, and groups which benefit from exempt status are required to pay a charge of £5000 per exempt entity at the time of review (see 'Fees and Charges' *ibid*). There appears to be no equivalent of the exempt charges in the funding structure of the South African Panel. Although s 440L of the South African Companies Act makes reference to an exemption being granted by the South African Panel, it would appear that such an exemption applies to a specific transaction and not to an entity. Indeed, section A3 of the South African Code, which deals with the companies to which the Code applies says that 'the Executive Director may *exempt any particular transaction* affecting a private company if satisfied that there can be no prejudice to minority shareholders' (emphasis added).

It is submitted that introducing the concept of exempt status fees to the funding structure of the South African Panel would give it an extra source of revenue, and would help to ease its financial problems. In addition, the concept of exempt status could, in certain cases, result in cost savings by obviating the need to investigate what investment mandates asset or fund managers hold in any given case, in order to determine whether or not they acted in concert. An example was the *Comparex Holdings* case (see Securities Regulation Panel Ruling, available at <http://www.srpanel.co.za/Publications.htm>, accessed on 2 June 2008). In that case the Panel had to determine whether asset managers who had acquired 35 per cent of the shares in a company on behalf of their clients had acted in concert in acquiring these shares.

From the foregoing comparative analysis of the funding structure of the London Panel, one could suggest that the PTM levy and the exempt fees are sources of income that the Panel in South Africa would do well to incorporate in its funding structure so as to boost its finances and enhance its efficacy in enforcing the Code.

#### FUNDING OF THE NEW ZEALAND TAKEOVERS PANEL

The New Zealand Panel, like the South African Panel, is a statutory body (see s 5 of New Zealand Takeovers Act 107 of 1993; hereafter the Takeovers

Act). Its funding is provided for in ss 17 and 17A as read with s 46 of the Takeovers Act. One source of funding for the Takeovers Panel is the annual fee levied on companies in terms of s 17(1) of the Takeovers Act, which provides that 'each specified company shall pay such annual fee in respect of the funding of the [Takeovers] Panel as may be prescribed by regulations made under this Act'. This fee is similar to the South African Panel's levy, which is based on a percentage of the annual listing or initial listing fee charged to listed companies by the JSE, in that the two fees are charged to companies on an annual basis.

Section 46 of the Takeovers Act empowers the Governor General to make regulations for the purposes of prescribing the fees and charges that the Takeovers Panel may require to be paid to it in connection with the exercise of any of its powers. In terms of the regulations promulgated under this section, the Takeovers Panel charges fees for applications for exemption from compliance with requirements of the New Zealand Takeovers Code (the Takeovers Code), fees for various approvals — such as an application for consent to withdraw an offer under rules of the Takeovers Code, and fees for meetings held by the Panel in terms of the Takeovers Act (see The Takeovers (Fees) Regulations 2001 Administrative Guidelines, available at <http://www.takeovers.govt.nz/act/fees.htm>, accessed on 2 June 2008)). With the exception of the fees charged for applications for exemptions from complying with the provisions of the Takeovers Code, it would appear that the fees charged by the Takeovers Panel are similar to those charged by the Panel in South Africa for the various services provided by it in terms of rule 2.2 of the administrative rules as read with the Schedule of Fees and Charges.

In addition to the fees noted above, the Takeovers Panel is also funded by the appropriation of money by Parliament from the national budget (see 'Sources of Funding' in Takeovers Panel Annual Report (2006), available at <http://www.takeovers.govt.nz/publications/ann-rep-06/02.htm>, accessed on 2 June 2008). The Takeovers Panel's 2006 Statement of Financial Performance (available at <http://www.takeovers.govt.nz/publications/ann-rep-06/03.htm#performance>, accessed on 2 June 2008) shows that such government funding equalled its baseline funding (ie met the Takeovers Panel's minimum financial requirements). In this respect the funding structure of the Takeovers Panel differs from that of its South African counterpart. There is nothing in the latter's financial statements, the Code or the Companies Act to suggest that it derives any of its funding from the South African treasury. Given that the South African Panel is struggling to build up its financial reserve to the desired level of R10 million (see Securities Regulation Panel Annual Financial Statements for the year ended 28 February 2006, available at <http://www.srpanel.co.za/Annual%20Report%202006.pdf>, accessed on 2 June 2008), it is recommended that the Panel's funding structure be reviewed so as to provide for some government funding, as is the case with the New Zealand Takeovers Panel.

## RECOMMENDATIONS AND THE COMPANIES ACT OF 2008

Based on the comparative analysis of the funding structures of the New Zealand Takeovers Panel and the London Panel, it is submitted that the

funding of the South African Panel could be enhanced by incorporating into its funding structure additional sources of revenue such as the PTM levy and the exempt status fees. Government funding, as in the case of the New Zealand Takeovers Panel, should also be considered.

In considering the above changes, it should be noted that the existing Panel will in all probability be reconstituted as the Takeover Regulation Panel (see s 196(1) of the Companies Act of 2008). The new Act proposes far reaching amendments to the existing Companies Act. The legislative changes proposed under the new Act will also impact on the existing Panel's funding structure. For instance, s 210(1) of the new Act provides that the Takeover Regulation Panel will be financed from money appropriated by Parliament, any fees payable in terms of the Act, income derived from the Takeover Regulation Panel's investment, and deposits of surplus money and other money accruing from any source.

The proposed changes relating to the Panel's financing constitute a major shift from the existing legal position. First, under the existing legal regime, s 440C(4)(a), as read with s 440E of the Companies Act, empowers the Panel to make rules providing for the administration and financing of the Panel. Details of how the Panel is funded are then set out in the rules made by the Panel (see rules 2.1 and 2.2 of the administrative rules in the Code). It would appear that in terms of s 120 of the new Act, the power to make rules providing for the administration, operation and procedures of the Takeover Regulation Panel or any other matter relating to the powers and functions of the Takeover Regulation Panel will now be vested in the Minister responsible for companies, as opposed to the Panel, which is currently the case. At the same time, details of how the Takeover Regulation Panel is to be funded will no longer be laid out in the rules made by the Panel. Rather, they will be provided for directly in the proposed Act (see s 210(1) of the new Act). Furthermore, the new Act introduces a major change in the funding structure of the Panel in that the Takeover Regulation Panel will be funded from public funds, whereas currently the Panel receives no public funding. In addition, it would appear that the new Act does away with the existing Panel's primary sources of financing, namely: fees for services and the fee based on a percentage of the annual listing fees; and initial listing fees charged by the JSE to listed companies (currently provided for in rules 2.2 and 2.1 of the administrative rules of the Code). Although s 210(1)(b) of the new Act makes reference to 'any fees payable in terms of the Act', there appears to be no other provision in the new Act providing for the payment of any such fees. Thus it is unclear what the fees to which the new Act refers are.

It is commendable that the legislature proposes to finance the Takeover Regulation Panel from money appropriated by Parliament. This a new and positive feature of the funding structure for the reconstituted Panel. The change provides a new source of funding which may improve the Panel's financial position. Financing a regulatory body such as the Panel from public funds is not an unusual arrangement: as discussed above, similar regulatory bodies such as the New Zealand Takeovers Panel are partly funded from

public funds. However, the new Act does not make it clear how much of the Takeover Regulation Panel's funding needs will be funded from the public purse. To avoid straining the national budget, it is recommended that the Takeover Regulation Panel's funding from the public purse be limited to its baseline funding needs. The Takeover Regulation Panel should accordingly be allowed access to public funds only to the extent that fees from other sources are insufficient to meet its operating needs.

It is submitted, though, that there is still scope for improvement in the changes to the Panel's funding structure proposed under the new Act. The existing funding structure, though inadequate, has kept the Panel afloat since its establishment in 1989. Therefore, there is no need to discard it as a whole, but rather to supplement and to improve it. It is recommended that in addition to public funding, the Takeover Regulation Panel's funding structure should reflect a balance between those parties directly involved in takeover activity, and market participants. Those directly involved in takeovers, as well as other investors, could bear part of the burden of financing the Panel. Accordingly, it is suggested that the legislature should not completely do away with the existing funding structure that levies fees on listed companies as well as fees based on the value of takeover deals.

It is further suggested that the existing funding structure may be improved by the addition of a fee similar to the London Panel's PTM fee, which is levied on specified transactions in securities on specified markets. For example, the fee could be levied on investors when they buy or sell securities of a specified amount on either the JSE's main board or the JSE's alternative exchange (AltX). It is also recommended that the existing funding structure be improved by the introduction of the concept of exempt status fees similar to the exempt charges provided for in s 13 of the London Code. As discussed earlier, the concept of exempt status will result in additional revenue to the Panel. In certain cases, it could also result in cost savings by obviating the need to investigate what investment mandates asset or fund managers hold in any given case, in order to determine whether or not they acted in concert.

It is hoped that by enhancing the existing funding structure as recommended above, and by supplementing it with limited public funding, this will improve the Panel's finances, thereby enhancing its ability to enforce the Code, but without placing a heavy burden on the national budget.

## CONCLUSION

This note has shown that the Securities Regulation Panel is inadequately funded, and that this impacts negatively on its ability to discharge its mandate to monitor compliance with and enforce the Securities Regulation Code on mergers and takeovers. The Panel's funding structure was examined and shown to have weaknesses that contribute to the Panel's relatively poor financial position. A comparative analysis of the funding structures of the Panel with similar regulatory bodies such as the UK's London Panel and the Takeovers Panel in New Zealand showed that the Panel's funding structure

provided fewer and contracting sources of revenue. The note also showed that the new Companies Act attempts to address the Panel's financial problems by providing for state funding. While state funding could go some way towards improving the Panel's finances, it could also place a heavy burden on the state budget if public funding was the Panel's only source of income. We have suggested a two-pronged solution to the Panel's financial problems: to modify the existing funding structure by expanding the sources of revenue available to the Panel; and to make provision for baseline funding from the public budget. For example, the Panel could be empowered to levy a fee on investors when they buy or sell securities of a specified amount on both the JSE's main board and the JSE's alternative exchange (AltX). Such a funding mix would ensure that those directly involved in takeovers, as well as other investors, would bear part of the burden of financing the Panel, thus avoiding excessive strain on the public budget.