

EXPLORING THE JSE PROCEDURE AROUND FAILURE BY THE STORAGE OPERATOR

1. Introduction

The purpose of this document is to provide an overview of the procedures that will be followed in the event of a failure by a JSE-registered storage operator to comply with its obligations as set out in the JSE's Requirements for storage operators ("the Requirements"). We will also deal with the manner in which the potential consequences of such a failure will be managed and the impact that it may have on clearing members, members, and clients. As we reference the Detailed Agricultural Contract Specifications and different incidents that have occurred over the exchange's history, the impact of failure by a storage operator on their contractual obligations will be simulated in order to provide readers of this document with practical examples to assist them in understanding the obligations imposed on each market participant by the JSE's Rules, the Contract Specifications, and the Requirements.

2. Obligations of the JSE registered Storage Operator

The Detailed Agricultural Contract Specifications Appendix C and D define and record the obligations of a JSE approved Storage Operator in respect of both the storage operator and its registered sites.

The key requirements for the Storage Operator focus on the following:

- Financial standing and importantly the Net Financial Worth linked to registered storage capacity. This scales from a minimum of R20 million up to R1 billion requirement.
- Defined minimum experience, expertise and the equipment required to provide storage services as a JSE registered site.
- The entity must be a South African registered legal entity.
- Commitment to abide by the JSE Rules and Contract Specifications as promulgated.
- Comprehensive record keeping abilities, agreement to be subject to independent inspections and provide reporting requirements in a prescribed format.
- Additional duties are defined to assist with the safe and secure transfer of ownership in a practical and robust manner.
- Definition of the required insurance cover and the annual reporting obligations.
- Prescribed handling procedures to be followed as well as clarity regarding the force majeure situations.
- The procedures and requirements to ensure clients can access product held on JSE silo receipts in a clearly articulated and fair manner.
- A dispute resolution process and how this will be facilitated
- Finally, confirmation that the JSE is empowered with the final decision-making process regarding the approval and continued registration of a JSE approved storage operator.

Appendix D records the requirements for a registered storage site in respect of all types of storage. Importantly the registered storage operator provides an unequivocal undertaking to comply with all its obligations as recorded in the Requirements such as:

- A minimum storage capacity per site of 10 000 metric tonnes with commitments to ensure road access, confirmed land ownership or minimum leasing requirements of the land used for the storage infrastructure.
- Minimum out loading capabilities under a defined all weather out loading criteria.
- Confirmation that the JSE reserves the final right to approve a storage site.

- In the event a storage site does not meet with the JSE's approval the deregistration process of the individual site is described.
- In addition to the above point, should a storage operator voluntary request deregistration of a storage site, the process is also defined.

The JSE supervises and enforces compliance with all the Requirements applicable to registered storage operators both in respect of the registered entity as well as the individual storage sites. If there are any uncertainties or concerns regarding a storage operator's compliance with the Requirements, market participants are encouraged to email these and supporting documentation directly to commodities@jse.co.za for further action.

3. Market participants' obligations to make physical delivery as recorded in the JSE's Rules and Contract Specifications

The ability and obligation to make or take physical delivery remains a critical component of the JSE's listed commodity derivative contracts. In order to ensure price convergence of a futures contract with the spot market, physical delivery must be easily accessible to market participants, and this can easily be accomplished. The Detailed Agricultural Contract Specifications form the basis for describing the physical delivery process in completion of an agricultural futures contract. Please refer to the JSE's Derivative Rules read with Appendix E and F that deals with the procedures, terms, and conditions in the issuing of an electronic JSE silo receipt.

4. Defining the JSE silo receipt and its legal nature

A JSE silo receipt "means a transferable document of title in terms of which the holder thereof may demand delivery to him by the storage operator of grain of a quality and quantity as described on the receipt, subject to payment of the storage operators' storage costs as provided for in terms of the receipt. JSE silo receipts have to be issued by an approved storage operator in electronic form (Appendix B) and on the terms set out in these contract specifications."

The JSE Silo Receipt is a fully transferable document of title and is used to deliver the underlying commodity from the short position to the long position holder in fulfilment of their obligations as recorded in the JSE's Rules and Contract Specifications.

The integrity of the JSE Silo Receipt is a foundational cornerstone of the JSE's agricultural derivatives market – the warranties and representations made by storage operators in issuing JSE receipts, including the terms under which commodities are stored through these receipts, are all aimed at ensuring that commodities stored in terms of JSE receipts are sacrosanct. To put it another way, if a storage operator issues a receipt, the entire market must have complete confidence and certainty that the quantity and quality of the commodity are stored at the location indicated on the receipt and that the holder of the receipt will be able to obtain delivery of its commodity without undue delay.

5. The physical delivery process in completion of a futures contract and the role of the different participants:

- JSE Approved Storage Operator: is responsible for guaranteeing that the required quantity and quality of grain as per the JSE silo receipts issued is available within the prescribed context when the owner of the grain requests the product.
- Client: is responsible to either present or take ownership of a valid JSE silo receipt in order to meet either the clients long or short position for the specific delivery month obligations.
- Member: in the event they are making or taking physical delivery in their own name, they assume the same responsibilities as their client. In addition to this, should their client not make valid delivery as described in 3.1 (i) of the contract specifications, the member is responsible to provide valid JSE silo

- receipts in completion of a futures contract. If the member's client is taking delivery and their client does not honour their obligation, the member is responsible for full payment of the physical delivery.
- d. Clearing Member: although the clearing member participates in the day-to-day physical delivery settlements, the clearing member will only be required to provide replacement JSE silo receipts or payment of physical delivery if the client and then the member firm defaults and do not honour their obligation in terms of the futures contract.
 - e. Electronic JSE Silo Receipts System Operator: currently through the services of Silocerts Pty Ltd, electronic JSE silo receipts are administered via the electronic platform however the storage operator remains responsible for issuing and guaranteeing the quality and quantity of JSE silo receipts. The responsibility of the system operator is to ensure the software is operational over key JSE physical delivery operating times and ensure the safety and security of electronically issued JSE receipts held in its secure database.

6. The principle of “making good delivery” and the expectation of the short position holder and long position holder to the physical product

This principle of good delivery is articulated in section 3.1.i of the detailed agricultural contract specifications and for ease of reference is repeated below

3.1. i Valid delivery against an open futures position

Valid and acceptable delivery against an open futures position will only be accomplished if the delivery of the JSE silo receipt enables the long position holder to take possession of the underlying commodity as detailed on the receipt. Valid and acceptable delivery will not be accomplished if a short position holder delivers a JSE silo receipt against an open futures position and the long position holder cannot take possession of the underlying commodity due to the default of the storage operator, unless the short position holder can prove that, at the time of the delivery of the receipt, the long position holder could have obtained possession of the underlying commodity from the storage operator.

There have been previous demands to limit or limit the time period for which the short position holder is accountable for assuring legitimate delivery. The grounds behind a short position holder's responsibility to provide "good delivery" are simply a restatement of the applicable legal standards in the sale of goods that have been in effect since Roman times. To put it another way, if we remove the criterion of "good delivery" from the contract requirements, the duties of the short position holder remain unchanged since they must still state that they transferred ownership of the underlying commodity when the silo receipt was delivered.

In the current construct of the contract specifications, it is not, nor can it lawfully ever be, the long position holder's obligation to ensure that transfer of possession was made, nor should this risk be borne by the long position holder. This is especially true in the current context, where commodities are allocated at random. A long position holder receives commodities covered by silo receipts, pays for these commodities covered by the silo receipts, but must bear the risk and/or prove that the seller transferred possession of the underlying commodity. This is clearly an untenable scenario, and there is no need to alter the well-established legal principles governing the transaction.

It is critical to distinguish between a storage operator's breach of requirements and a short position holder's obligation to make good delivery – issuing receipts in circumstances where there is insufficient quality and/or quantity of product at the location indicated on the receipt is a breach of the storage operator's requirements, but it may not necessarily

result in a short position holder's inability to effect delivery. In the case of Suidwes' violation of the storage operator regulations, all holders of Suidwes' silo receipts were able to and did make good delivery. If Suidwes had not honoured their obligations and provided physical stock, they would have been in default. In addition, if a storage operator fails to comply with the requirements, a short position holder may not be able to effect delivery, in which case the short position holder will have a claim against the storage operator.

There has been confusion in the past by some market participants who felt good delivery was not made. This is because the long position holder could not immediately access the product in the silo complex where the receipt was issued. It is therefore imperative to understand that taking delivery of JSE silo receipts does not give immediate access to grain. Owners of JSE silo receipts must follow the protocols of each operator to secure out loading slots. JSE silo receipt holders do not have exclusive access to registered storage facilities. They can instead access them along with stock held on folio accounts of storage operators and the storage operators' silo receipts. Due to this, the JSE requires storage operators to offer out loading slots on a first-come, first-served basis, and to treat all requests fairly. It is possible, therefore, that JSE receipt holders may have to wait over three or four weeks before out loading can begin for stock represented by JSE silo receipts. To provide market participants with improved access to stock during the main hedging months, the JSE introduced updated chapter 9 to Appendix C in 2021. The storage operators have allowed in a prescribed manner JSE receipt holders access to reserved 25% of their out loading capabilities. This is between the 25th of the main hedge month and the following 25th calendar day of the following month. For the first time, JSE receipt holders will have access to the "reserved" out loading capacity.

Certain market participants have expressed concerns about the risk to short position holders in proving they have made valid deliveries. This is because they do not have direct access to audit the specific storage site where the JSE receipts are issued. They have expressed vulnerability due to this reliance on the storage operator who issued the JSE receipts to honour them. In recognition of the concerns raised and the practical challenges involved in trying to audit each silo complex with every delivery of JSE silo receipts, the JSE strikes a careful balance between the obligations of the storage operator and the short position holder.

The JSE has only ever acted against short position holders twice in the history of the commodity derivatives market - in 2007 and in 2020. In both these instances, it was clear from the facts that the short position holders did not make a satisfactory delivery. This is because, on their own version, they were aware of the issues and problems at the silos in question. In neither case was there a practical difficulty in proving successful delivery. Instead, it was clearly an instance where, on the facts, they knew about the issues at the silos in question. It was beyond dispute that they failed to make a good delivery as defined in the JSE's Rules and Contract Specifications.

If it is ascertained that the short position holder did not make good delivery, they will be required to provide replacement JSE silo receipts to uphold their obligations to the long position holder, and the short position holder will have a direct claim against the storage operator as outlined in Appendix C Section 1.5.

7. What is considered a failure by a Storage Operator?

What market participants often refer to, in common parlance, as a Storage Operator default, it would be more correct to refer to the failure of a Storage Operator to comply with its obligations as recorded in the Requirements. "Default" has a specific and narrowly defined meaning in the JSE's Rules.

A Storage Operator who is unable to supply the requisite quantity and quality of grain as stated by a JSE silo receipt will be in breach of their obligations as recorded in the Requirements.

That said there may be exceptional circumstances where replacement stock may be presented to the owner of the JSE silo receipt or in the case of wheat the quality may change by one grading standard. The exception is described in Appendix C section 6.4 and 6.5 that and reflected below:

6.4 The location indicated on the silo receipt reflects the registered delivery location of the product where the product should be made available. The JSE however, accepts that exceptional circumstances may exist that would necessitate a change in the registered delivery location where the product is made available. These circumstances must be notified in advance, unless such notice is not reasonably possible to the JSE. The storage operator shall be liable for any additional transportation costs occasioned by the holder of the JSE silo receipt due to the storage operator's alteration of the delivery location appearing on the face of the receipt.

6.5 With specific reference to the out loading of wheat, the storage operator undertakes to out load the quality of wheat as indicated on the face of the receipt. The JSE however accepts that circumstances may exist due to the complexities of storing wheat that result in the specific quality not being available, in this instance the storage operator may out load one grade category better or worse, based on the quality indicated on the face of the receipt. The difference in grade quality will either be reimbursed or collected from the holder of the JSE silo receipt using the grade premium or discounts as determined by the JSE for that marketing season with the adjustment applied at the time of out loading.

There has only been one incident of a storage operator contractual failure in the exchange's history, which pertains to the North West Province's Directorate of Entrepreneurial Development (DED), which defaulted on 5028 tons in 2007. To put the failure into context, the JSE now has 15 Approved Storage Operators with a total storage capacity of more than 18 million tons.

8. Discuss the context of the “Vryhof” failure and the procedures that followed highlighting the enhancements made to the agricultural contract specifications.

As indicated in the previous section, the only storage operator failure refers to an amount of 5028 tons of white maize held on Safex silo receipts guaranteed by the DED. At the time, Commodity Trading House (CTH) participated in assisting with the operations at the silo complex however throughout the registration process DED had undertaken to honour all Safex silo receipts issued. What started out with over 100 000 tons in storage, when it came to the remaining 5028 tons the JSE was informed by CTH that they would not be in a position to honour their final silo receipt obligations. Since DED had undertaken to honour all JSE receipt obligations, the JSE proceeded to take the necessary and appropriate steps to deal with and manage the consequences of the DED's failure to comply with its obligations.

Since the bulk of the silo receipts had been delivered through the exchange, the JSE, in collaboration with CTH, located the remaining paper receipts in circulation and began to reconcile the transfer of ownership information, namely who the short and long position holders were. The usage of paper silo receipts, as well as the fact that a number of the receipts were reissued into smaller quantities throughout the JSE physical delivery procedure, complicated the reconciliation process.

Once the entire ownership transfer audit trail was completed, the JSE approached the original short position holder to provide supporting evidence that good delivery was made at the time of initial delivery. The JSE decided, after carefully considering all the facts and information at its disposal and enlisting the assistance of senior legal counsel for additional guidance on the matter, that the short position holder was aware that there was a dispute about the quantity and quality of maize held at this silo and that it did not make good delivery as recorded in the JSE's Rules.

The JSE instructed the short position holder to deliver replacement receipts to ensure that it meets its delivery obligations. Although there were several additional long and short position holders involved in the transfer of ownership process of the receipts, the JSE only engaged with the initial short position holder who made delivery onto the JSE and the final long position holder who received delivery from the JSE.

To address the situation, the short position holder filed a high court lawsuit against DED. Although long position holders had a minor delay in getting new JSE silo receipts as the JSE went through the procedure to determine which short position holder failed to make legal delivery, long position holders did receive replacement stock in the end. It took significantly longer for the short position holder to resolve the situation in court, but the lawsuit against DED was eventually concluded years later.

In order to improve the process of managing a storage operator failure and limit the impact as far as possible on both long and short position holders, the JSE proceeded to implement a number of improvements to the detailed contract specifications. Some of the more pertinent changes to **Appendix C** included the following:

- Extracted from paragraph 1.5 - *"...the storage operator shall within 24 hours of notification by the JSE pay a cash settlement to the holder of the receipt. The storage operators agree and undertake to pay a cash settlement to the holder of the receipt in the event of any failure by a storage operator to comply with its delivery obligations as recorded on the face of the receipt and these contract specifications. The cash settlement value will be determined by the JSE by referencing the near month mark-to-market price of the applicable product as traded on the JSE, discounting any differentials and grade premiums or discounts that may be applicable. In addition, thereto, the storage operator will be liable for a cash penalty of an additional 30% of the cash settlement value as determined by the JSE, of which a portion will be payable to the holder of the receipt."* **The intention of this is to ensure the short position holder can avoid legal action in the courts to resolve the failure by the storage operator and secure cash settlement as a swift resolution.**
- Paragraph **1.6 prioritises the cash settlement process with the Storage Operator** and states *"In the event of any dispute between the storage operator and the holder of the receipt, the storage operator agrees and warrants that, apart from its lien for outstanding storage as indicated on the receipt, it will not raise any defence that will or may result in a delay or failure to deliver the commodity covered by the JSE silo receipt to the holder thereof. The storage operator agrees and undertakes that it shall only pursue any claims that it may have against the holder of the commodity stored in terms of JSE silo receipts after delivery of the commodity or payment of the cash settlement contemplated in paragraph 1.5 of Appendix C. The storage operator further agrees that set-off may not be applied between any claim that it may have against the holder of the silo receipt and the cash settlement contemplated in paragraph 1.5 above."*

- Further **paragraph 4.5 also clarified that no other storage terms** other than JSE terms and conditions are applicable to JSE silo receipts where with the Vryhof dispute the screenings dispute may have exacerbated the default situation. The clause reflects the following *“The storage operator undertakes and warrants that it will not conclude any concurrent storage agreements that may have terms that are inconsistent or in conflict with the JSE’s Rules, Contract Specifications and Appendices thereto with any party in respect of commodities stored in terms of JSE silo receipts. In the event of such inconsistency or conflict, the provisions of the JSE’s Rules, Contract Specifications and Appendices thereto will prevail.”*
- To **ensure an improved ability to monthly audit storage operators stock levels and ensure full details of all JSE silo receipts** in circulation paragraph 5.7 was added. It should be noted that when the JSE moved to only accept electronic silo receipts the JSE has real-time access to all JSE silo receipts in circulation. The section 5.7 is defined as follows: *“The storage operator shall submit monthly returns in the prescribed format to the JSE reflecting the total tonnage of JSE traded grain products in storage per type, quality and location as represented by JSE silo receipts, individual receipts and grain held on folio (includes grain held for third parties). The information is supplied to enable the JSE to fulfil its regulatory duties and responsibilities. The JSE will use the consolidated information per location to confirm and ensure that the total receipts issued do not exceed the capacity of the delivery point. The information is provided on a confidential basis and has to be verified and approved by the financial director or chief financial officer of the storage operator.”*
- In addition to the above, paragraphs 5.8 and 5.9 were added as additional oversight requirements from Storage Operators where independent audit reports are required to confirm stock levels and SAGIS inspection reports would also be shared with the JSE.
- Section 6.6 through until 6.12 was added to further clarify the legal position of the holder of a JSE silo receipt with regards to co-mingling of the grain.
- Finally, section 10 was enhanced to provide additional clarity around the dispute process involving storage operators and JSE silo receipt holders and the access to arbitration proceedings.

9. Define the sequence of events expected to follow from a Storage Operator contractual failure.

To provide market participants with a detailed understanding of the envisaged sequence of events should a JSE registered storage operator fail in terms of their JSE contractual obligations, consider the following:

Identifying the breach of contract

- a. JSE silo receipt holder notifies the JSE that the storage operator fails to honour physical delivery of the JSE receipts as requested
- b. Storage Operator will be contacted by the JSE and required to confirm that they are not honouring the JSE receipts that they issued in terms of the Agricultural Contract Specifications

- c. JSE informs Storage Operator that it is in breach of their obligations which will prevent the further issuing of any JSE silo receipts by the storage operator and their ESC account will be suspended until further notice
- d. JSE Market Notice of the failure will be disseminated to the Commodity Derivatives Market suspending all registered delivery points of the storage operator in question until the impact of the failure is understood- the suspension may become irreversible depending on the situation.
- e. This will impact all JSE silo receipts issued by the Storage Operator as they will no longer be deliverable until the contractual failure is resolved.

Assessing the impact of the breach of contract

- f. JSE immediately instructs independent audit of all storage facilities to confirm physical stock quality and quantity held at each registered facility.
- g. Review all JSE deliveries in process – exchange traded vs cash market
- h. JSE reviews the ownership transfer records and will begin a process to identify which position holder will institute cash settlement claim as defined in the detailed contract specifications.
- i. Each short position holder will be consulted via the member firm with whom they traded to evaluate the valid delivery principle starting with the most recent short position holder who made delivery of the impacted JSE silo receipts and working through the ownership transfer records to identify which owner of the JSE silo receipts will institute the financial claim against the storage operator.
- j. The JSE may have insight into stock levels at a certain instance in time via the independent audits to assist short position holders confirm there was stock to honour the JSE receipt at the instance of transferring ownership. This information will be referenced to decide which holder of the JSE silo receipt will institute the financial claim against the storage operator.
- k. There is a possibility that we go all the way back to initial short position holder to provide replacement stock and thereby claim against the storage operator
- l. The JSE appreciates that it is highly unlikely that every short position holder who has received delivery through the JSE or traded the JSE silo receipt in the cash market will necessarily have full supporting documentation to prove valid delivery and hence the importance of ensuring that once a storage operator is declared to be in breach of contract, cash settlement is resolved swiftly. It remains critical that the JSE identify a position holder as quickly as possible whom will take up the cash settlement claim against the storage operator who has failed to honour their obligations.

Identifying who will provide replacement JSE silo receipts to complete the physical delivery process of the JSE.

- m. Depending therefore on information available to the JSE, external legal counsel may also be consulted; the JSE will then identify who did not make valid delivery in terms of their physical delivery in completion of a futures contract.
- n. If this is the short position holder, they will be required to provide replacement JSE silo receipts within a period reasonable to the quantity of stock required. In the previous instance of just over 5000 tons replacement stock was required within 48 hours.
- o. The replacement receipts are required to ensure valid delivery was made and will be handed over to the long position holder adjusted for location differential and any other adjustments ensuring the long position achieves valid delivery.
- p. If the short position does not provide replacement receipts, the member firm of the short position holder will be required to fulfil their obligations. The client will be placed in default and the member

firm will proceed with the default arrangements of a client closing out all open positions and using any remaining initial margin to settle any amount due.

- q. The default procedures to follow are those as defined in the derivative rules and specifically section 12.
- r. If the member firm does not provide replacement receipts, the member will be placed in default and the clearing member will be required to provide replacement receipts.
- s. In the highly unlikely event that the clearing member does not provide replacement receipts and default on their obligation, the Clearing Member will be placed in default and from here the well published default proceedings of a clearing member will be followed to ensure the long position holder is settled for their physical delivery.

The cash settlement claim against the storage operator

- t. As soon as the replacement receipts have been provided, the party that provided these will have a claim against the storage operator who failed their contractual obligations, and it is this same party that will seek cash settlement as described in Appendix C 1.5 of the Detailed Contract Specifications.
- u. Where the JSE views the delivery as being valid, the current holder of the JSE silo receipts will have to seek cash settlement from the storage operator.
- v. The cash settlement value as well as 30% cash penalty will be determined by the JSE within 48 hours of identifying the storage operator failure.
- w. The contractual obligation of the storage operator is to pay over the cash settlement value within 24 hours of receiving the request, these funds will then be paid over to the short position holder who provided the replacement receipts.
- x. Should the storage operator be liquidated and not able to settle the cash settlement amount including penalty, the holder of the receipt would then have to submit a claim to the liquidator.

10. The ability to declare a dispute with a Storage Operator in terms of the contract specifications and the process that will follow

Section 10 of the contract specifications' Appendix C gives the required clarification regarding the dispute settlement process. Arbitration shall be used to resolve any disputes between the storage operator and the owner of the JSE silo receipt, as outlined by the Arbitration Act. The JSE will be responsible for appointing the arbitrator. The arbitrator's decision is final and binding on the parties, and the arbitrator is not obliged to provide reasons for his decision.

11. Penalties applicable to Storage Operator as defined by the contract specifications for breaches of the contract specifications

The penalties section described in Appendix C section 4 was recently clarified and defined as follows: *"The storage operator acknowledges and agrees that the JSE is entitled to rely on and impose any of the following contractual remedies if a storage operator fails to comply with its obligations as recorded in these contract specifications and on the face of JSE silo receipts and/or if it breaches any of its obligations, representations and warranties in issuing JSE silo receipts:*

4.2.1 Provision of additional financial guarantees to the JSE to the maximum value representing all JSE receipts currently in issue and/or;

4.2.2 A financial penalty due to the storage operator's breaches of its obligations as set out in these contract specifications and on the face of JSE silo receipts to a maximum of R 5 million and/or;

4.2.3 *Deregistration as a JSE approved Storage Operator including the deregistration of all registered delivery points.”*

12. Describing the various audit and control checks in place by the JSE to measure compliance by the Storage Operator of their requirements as defined by the Agricultural Contract Specifications

The JSE has strengthened its auditing processes for registered storage operators over the years to guarantee compliance with JSE rules. It is critical to familiarise oneself with Appendices C and D of the contract specifications to grasp the requirements. To better understand the audit processes in existence, they are classified into three types:

Annual audit requirements: Storage operators must produce audited financial statements, stock confirmation reports confirmed by independent auditors, confirmation of insurance coverage for the next 12 months, and proof of infrastructure capabilities and compliance for all registered locations. If they were audited during the preceding reporting period, operators must additionally provide a copy of the SAGIS audit report.

Monthly audit requirements: A significant component of the JSE's monthly evaluation of its registered storage operators is the submission of a monthly stock report that contains the TOTAL stock position maintained at each registered location. These reports not only provide the JSE with entire control of stock held with each operator, but they are also used to assess each operator's risk in terms of total stock held in the country. The JSE can also utilize them internally to determine where anticipated concentrations of stock issues may emerge and selectively ensure independent audits are centred on higher risk locations. The JSE also targets a minimum of ten storage sites for independent inspection each month, with these inspections not only focusing on reporting stock quality and quantity at the site, but also providing insights into the registered delivery point's compliance with the JSE requirements outlined in Appendix D.

Random audits, inspections, or activity logs: The JSE reserves the right to request unaudited financial statements or financial guarantees at any time if it believes there is a risk in a storage operator's performance. Similarly, independent examination of physical stock, as well as a request for sight of out loading slot allocations, can be requested at any time from the storage operator. The JSE also publishes any operational incidents that occur at a storage location, such as major breakdowns or fumigation concerns, on a dedicated webpage, which would prevent stockholders from accessing their product. This is yet another essential approach for the market to gain more information about the operation of a storage facility and access to stock.

13. Reflect on various incidents that have occurred in the history of the exchange specific to JSE silo receipts and storage operators:

- a. PG Du Plessis incident in 2000: following an incident whereby various clients had transacted in the cash market with Mr PG Du Plessis using Safex silo receipts however were not paid for their commodity, these clients turned to the courts requesting an interdict be placed on the stock preventing the continued trading of the stock. Due to the negative knock-on effect of the interdict impacting not only the derivatives market but also cash market transactions, the JSE opposed the matter on the grounds that transfer of title was made when the owners of the silo receipts signed them off at the back of the paper receipt. The JSE's argument was that these clients should be restricted to financial claim for damages however the underlying commodity should continue to be traded.

Following this incident, the agricultural contract specifications were updated and more specifically 2.2 c with the specific reference:

“The transferor of a JSE silo receipt, who on the first occasion is the depositor, endorses the receipt and warrants that on the transfer date they are the owner of the agricultural product covered by the receipt and, other than the storage operator’s lien shown on the face of the receipt, there are no liens or other encumbrances on the said agricultural product except as stated thereon. Should any dispute arise between any parties relating to the transfer of the JSE silo receipt, such persons agree that their claims will be limited to monetary claims and that no person will be entitled to claim that they retain ownership or a real right to the product represented by the receipt after transfer of this receipt. In particular, no person will be entitled to vindicate property alleged to belong to such person and to the extent necessary waives any vindicatory remedies.”

- b. Vryhof incident in 2007 resulted in a number of enhancements to the contract specifications; these have already been discussed extensively in this report.
- c. Storage operators issuing JSE silo receipts when stock was held in other storage sites. There have been two occurrences of this breach of the contract specifications since inception, in 2012 by GWK and then again in 2020 by Suidwes Landbou. Although the agricultural contract specifications clearly articulate in Appendix C 6.3 and 6.4 the following requirements:

“The JSE silo receipt issued by the storage operator to the holder shall be irrefutable proof of the net weight and quality of the commodity stored on behalf of the holder of the receipt in the storage operator’s registered delivery location as recorded and warranted on the receipt.

The location indicated on the silo receipt reflects the registered delivery location of the product where the product should be made available. The JSE however, accepts that exceptional circumstances may exist that would necessitate a change in the registered delivery location where the product is made available. These circumstances must be notified in advance unless such notice is not reasonably possible to the JSE. The storage operator shall be liable for any additional transportation costs occasioned by the holder of the JSE silo receipt due to the storage operator’s alteration of the delivery location appearing on the face of the receipt.”

In both instances where the storage operator failed to adhere to the requirements of the detailed agricultural contract specifications, they received different forms of penalties from the JSE. One was required to present a financial guarantee to the value of R20 million to the JSE for the following year and the other received a financial penalty to the value of R1,5 million of which R750 000 was suspended. It is noted both storage operators cooperated fully remedying the situation by ensuring the position holders received the required quality and quantity of product at an additional cost to the storage operator. Both these situations were remedied by the Storage Operator and was not a complete failure by the Storage Operator to comply with its obligations.

- d. NWK’s shortfall of 943 tons at Ottosdal in 2020. The JSE took the necessary and appropriate steps after it decided that the short position holder did not make “good delivery” and the short position holder subsequently complied with all its obligations. The facts and information at the disposal of the JSE indicate that no party suffered any loss because of the short position holder’s failure to make good delivery. As a result, unlike in the case of Vryhof, no further action was required.

In the amendments the JSE made to the agricultural contract specifications in 2020, a new section 9 was added to Appendix C to further clarify and enhance the accessibility to stock for holders of JSE silo.

14. The expected process to follow in the event of a liquidation of a JSE Registered Storage Operator

- a. Market participants have on occasion asked the JSE how it would react if a JSE-registered storage operator went "bankrupt." Importantly, the storage operator does not own the commodities stored on behalf of silo receipt holders, and these commodities will not be included in the insolvent estate's assets. The impact of the liquidation would be determined in the end by the quality and quantity of stock held in storage versus the storage operator's commitments to its storage clients. As a result, if all the stock is still in storage and no shortages exist, the liquidation procedure should have the least impact on physical stockholders. The JSE anticipates the following sequence of events if a registered storage business is liquidated: JSE is informed a registered storage operator is placed under liquidation
- b. JSE will collaborate closely with the appointed liquidator to determine the current physical stock position.
- c. The JSE, as regulator of the exchange will have a direct interest in JSE silo receipts.
- d. The JSE will immediately commission an independent audit of all storage sites where JSE silo receipts are issued to assess the quality and quantity of stock held.
- e. The JSE will inform the broader market of the storage operator's liquidation and temporarily restrict physical deliveries from this storage operator's sites.
- f. At this time, no new JSE silo receipts may be issued.
- g. Upon receipt of confirmation of the existing quality and quantity of stock in storage versus silo receipt and folio commitments, JSE will collaborate closely with the liquidator to ensure stock can be accessed as soon as possible.
- h. This will necessitate the liquidator establishing a process to ensure the orderly booking of out loading slots and payment of outstanding storage of JSE receipts, it is anticipated that partnering with an existing storage operator with capacity to assist in resolving the practical operational issues will yield the best outcome.
- i. If there is no stock shortfall, strive to assist market participants access their stock for out loading as swiftly as possible
- j. If there is a stock shortfall, collaborate closely with the liquidator to agree on the shortfall and then ensure that existing quality and quantity of stock is maintained, and no further losses or deterioration of stock quality occurs. It will be important to divide the possible losses across all position holders whilst doing this ensure the stock that is stored can still be accessed in a structured and controlled manner.
- k. The holder of a JSE receipt decides to file a financial claim against the storage operator.
- l. Continue to collaborate closely with the liquidator until all JSE silo receipts have been out loaded and the final reconciliation process of losses is complete.

15. Conclusion

We trust this document published in 2022 is a useful reference for the market to appreciate the responsibilities of each stakeholder in the JSE physical delivery process of agricultural grains. Should there be any clarifying questions these can be address to the email group account of commodities@jse.co.za