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**TO:** **Chairperson, Standing Committee on Finance**
**[Mr Y I Carrim, MP]**

**COPY:** **Secretary to Parliament [Mr G Mgidlana]**

**FROM:** **Constitutional and Legal Services Office**
**[Adv F S Jenkins, Senior Parliamentary Legal Adviser]**

**DATE:** **2 April 2015**

**SUBJECT: Analysis of legal opinions on the constitutionality of the Banks Amendment Bill**

**MESSAGE:** **Attached please find a memorandum for your attention.**

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# MEMORANDUM

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**REF. NO.: 36 / 15**

**SUBJECT: Analysis of legal opinions on the constitutionality of the Banks Amendment Bill**

## Background

1. The Constitutional and Legal Services Office (hereinafter 'our Office') received a request from the Chairperson of the Standing Committee on Finance (hereinafter 'the Committee') for an analysis of the various legal opinions on the constitutionality of the Banks Amendment Bill [B17–2014] (hereinafter 'the Bill'). The Committee is considering the Bill for report to the National Assembly.

2. The Committee was provided with three legal opinions, two from National Treasury and one from the group of creditors, which hold Tier 2 debt

instruments (hereinafter 'the Subordinated Noteholders') issued by African Bank (hereinafter the 'ABL').

- On 8 December 2014, Adv D Unterhalter SC and Adv S Budlender provided a legal opinion to the National Treasury, advising that the Bill is consistent with the Constitution of the Republic of South Africa, 1996 (hereinafter 'the Constitution') and recommending certain amendments to the Bill, which will be discussed below. This opinion will be referred to as the National Treasury's opinion 1.
- On 10 March 2015, Adv A Cockrell SC and Adv I Goodman provided a legal opinion to the Subordinated Noteholders, finding that certain provisions of the Bill may be inconsistent with the Constitution. This opinion will be referred to as the Subordinated Noteholders' opinion.
- On 16 March 2015, Adv Unterhalter and Adv Budlender provided another legal opinion to the National Treasury, again advising that the Bill is consistent with the Constitution, this time taking into account the opinion provided to the Committee by the Subordinated Noteholders. This opinion will be referred to as the National Treasury's opinion 2.

3. The purpose of this memorandum is to analyse the different legal opinions in an attempt to provide the Committee with consolidated legal advice pursuant to finalising the Bill.

**The nature of the amendments**

4. For the purpose of this memorandum, there are two controversial amendments proposed by the Bill, both of which seek to broaden the powers of a curator to a bank.

5. First, the Bill proposes amendments to section 69(2C) of the Banks Act 94 of 1990 (hereinafter 'the Act'), which deals with the circumstances under which the curator may dispose of the bank's assets and liabilities. In short, the Bill authorises the curator to dispose of any assets and liabilities of the bank, outside the ordinary course of the bank's business, subject to section 54 of the Act. Section 54 requires the consent of either the Minister of Finance (hereinafter 'the Minister') or the Registrar of Banks (hereinafter 'the Registrar'), depending on whether the extent of the disposal or transfer is more than 25 per cent or 25 per cent or less, respectively.

6. For the purpose of the approval in terms of section 54, the curator must report to the Minister or the Registrar, as the case may be, on the effect of the disposal or transfer on whether: -

- the creditors are treated equitably; and
- a reasonable probability exists that a creditor will not incur greater losses on the date of disposal or transfer than he or she would have if the bank had been wound up on the date of the said disposal or transfer (so-called no-worse off provision).

7. The Minister is authorised to grant permission for the disposal or transfer even if the report indicates that these two conditions are not met if, in the opinion of the Minister, the disposal or transfer is reasonably likely to promote the maintenance of –

- a stable banking sector in the Republic; or
- public confidence in the banking sector in the Republic.

8. As indicated below, this provision omitted the role of the Registrar and the proposal is to insert the Registrar in this provision.

9. Second, the Bill proposes to insert a new provision as section 69(3)(j) the effect of which is to authorise the curator to raise funding on behalf of the bank, including raising security over the bank's assets, notwithstanding any contractual obligations of the bank. This provision is tempered by the proviso that any claim for loss or damage as a result of such security may be instituted against the bank after a period of one year from the date of such provision of security.

10. The latest provision from National Treasury is to limit the operation of this provision to raising funds from the Reserve Bank of South Africa.

**National Treasury's opinion 1**

11. Our Office provided the Committee with an analysis of this opinion on 16 March 2015 (attached for ease of reference). In essence the opinion by Mrs Vuyokazi Ngcobozi agreed with the opinion and recommendations from the National Treasury. I share the views of my learned colleague. In the interest of a consolidated memorandum to assist the Committee, I analyse the opinion below.

12. The brief to counsel came from National Treasury and was limited to whether the Bill is consistent with section 25 of the Constitution and to propose any suggested changes to the Bill. Subsection (1) of section 25 is applicable as it

allows the deprivation of property if it is in terms of a law of general application and this law does not provide for arbitrary deprivation.

13. The opinion found that the two provisions referred to above provide for the possible deprivation of property.

- In the first instance, the claim against the bank may be disposed of or transferred to a new party that might not be able to settle the debt; or the claim remains against the bank but the assets are transferred, leaving the debtor to face a bank with no or limited assets. This is a possible deprivation of property and the opinion refers to various court judgments by the Constitutional Court to support the finding.

- In the second instance, the curator may raise funds on behalf of the bank, including raising security over the bank's assets, notwithstanding any contractual obligations of the bank. As this has the potential of upsetting the "existing hierarchy of creditors" and cause loss or damage to the preferential status of some creditors, the opinion also considers this as a possible deprivation of property.

14. However, the deprivation of property is consistent with section 25 of the Constitution as it will be in terms of law of general application (viz. the Act and the Bill once promulgated) and this law does not provide for arbitrary deprivation, the two preconditions set out in subsection (1) of section 25. The major part of the opinion deals with the question whether the Bill allows for **arbitrary** deprivation of property.

15. The opinion relies on judgements from the Constitutional Court in analysing the two requirements to prevent arbitrary deprivation; namely, procedural fairness and substantive fairness or sufficient reason. **The latter is a variable standard fitting in between an enquiry into rationality and a proportionality examination.** Factors to be taken into account, to illustrate the complexity of this exercise, include purpose of the law in question, the person whose property is affected, the nature of the property, the extent of the deprivation and the relative relationships between these factors.

16. In applying the test, the opinion finds that the first deprivation permitted by the Bill – the disposal or transfer of assets and liabilities of the bank – would not be procedurally unfair as the exercise of this function by the curator must be authorised by the Minister or Registrar. The discretion of either of the latter functionaries is subject to the Promotion of Administrative Justice Act 3 of 2000 (hereinafter referred to 'PAJA'). PAJA sets procedural standards that act as a hedge against procedural unfairness and hence arbitrary deprivation. In this regard the opinion emphasizes that the Bill merely empowers the curator and the Minister or the Registrar to perform certain functions that may result in deprivation of property. The Bill does not in itself require deprivation of property. The discretion must be exercised, depending on the facts of the matter, and subject to the procedural requirements of PAJA.

17. The opinion also finds that the Bill requires sufficient reasons for the curator and the Minister or Registrar, as the case requires, in exercising their discretion to prevent arbitrary deprivation of property. In this regard the opinion relies on Constitutional Court judgments that interpret similar provisions as inherently requiring **proportionality** in the exercise of the discretion. Furthermore, the opinion states that the substantive grounds in PAJA will act as a hedge against arbitrary deprivation of property.

18. In respect of the second deprivation – the raising of funds on behalf of the bank including raising security over the bank's assets, notwithstanding any contractual obligations of the bank – the opinion finds that the possible deprivation of property is neither procedurally nor substantively unfair, and therefore the Bill does not permit arbitrary deprivation of property in this instance. Although the curator operates without the supervision of the Minister or Registrar in this instance, the curator's exercise of the discretion is subject to PAJA on both procedural and substantive grounds. **Proportionality** is again considered inherent in the provisions of the Bill and the curator will have to take it into account when exercising the discretion. Again the opinion emphasizes that the Bill does not require the curator to ignore the vested contractual obligations, the curator is merely empowered to do so. In this event, the creditors are still afforded a claim although after the period of one year.

19. In summary, the opinion finds that the Bill does not allow arbitrary deprivation of property in either of the two relevant amendments proposed by the Bill. Therefore it finds that the Bill is consistent with section 25(1) of the Constitution.

20. Lastly, the opinion recommends that the omission of the role of Registrar in approving the disposal or transfer of assets and liabilities of the bank be corrected and that the retrospective operation of the Bill be made explicit. The latter, it is stated, is to remove any ambiguity that the provisions of the Bill will apply to the curator of ABL, which is one of the objectives of the Bill.

21. For reasons that will become clear below, it is important to note that the opinion in paragraph 31 deals with the question of whether retrospectivity is inimical to

the **rule of law**. In this regard the opinion finds that "retrospective civil statutes are not inconsistent with the rule of law."

**Subordinated Noteholders' opinion**

22. As per the brief, the opinion analyses the possible exercise of the powers by the curator, Minister and Registrar provided for in the Bill in light of the contractual obligations between ABL and the affected creditors; namely, the Subordinated Noteholders.

23. The opinion considers the retrospective operation of the Bill as unconstitutional notwithstanding the legal position stated in the opinion [at par. 14] that "there is nothing intrinsically offensive in imposing civil obligations retrospectively". The reason for this is that the unsettling of existing transactions authorised by the Bill is inconsistent with the rule of law.

24. The **rule of law argument** is based on the premise that retrospective legislation has the potential to undermine the rule of law as it negates the ability of people to regularise their affairs in the "shadow of the law" or "in light of what the law demands" [at par. 15]. In the present situation, the Bill undermines the rule of law as it potentially interferes with vested contractual rights. The Bill authorises the curator, the Minister and the Registrar to "unsettle existing contracts and to expose creditors to new consequences that could not have been foreseen when they entered into contracts with ABL, and which would not have been factored into the pricing of those contracts".

25. In short, the exercise of these powers might override the vested rights of the Subordinated Noteholders. The crisp issue is that the Subordinated Noteholders rank *pari passu* (on equal terms) with the Senior Notes except in the event of a dissolution, liquidation or winding-up of ABL. The Bill allows the curator, Minister and Registrar, as the case requires, to make decisions that will have the same effect as a dissolution, liquidation or winding-up, except that ABL is not dissolved, liquidated or wound-up. Yet, the claims of the Subordinated Noteholders could be subordinated.

26. The rule of law argument applies to both relevant amendments highlighted above.

27. The opinion pursues a further argument – **the rationality argument**. The rationality argument (which according to the judgments referred to in the opinion is set at the lowest possible threshold and therefore would find it difficult to prevail in a court) concerns the legal question whether the purpose of the legislation serves a legitimate governmental purpose. The purpose of the Bill is to maintain public confidence in the banking sector, according to the opinion. However, the Bill permits arbitrary differentiating between creditors. As the latter is inimical to the former, the Bill is irrational as it defeats its own object.

28. The rationality argument will find application in the case where the Minister approves a disposal or transfer of assets and liabilities of a bank notwithstanding that the creditors will be treated inequitable because he or she is of the opinion that such disposal or transfer is reasonably likely to promote the maintenance of public confidence in the banking sector in South Africa when in fact the opposite is true and the decision of the Minister cannot be reviewed [at par. 54]. The possibility – i.e. the possibility of an incorrect

decision by the Minister that cannot be reviewed – is at the heart of the rationality argument because the Bill as it stands is therefore unconstitutional. However, the opinion admits that it would be probable that a challenge on this basis and in terms of PAJA would have to wait until an incorrect decision is taken.

29. Another challenge is based on the constitutional guarantee of equal protection and benefit of the law provided for in section 9(1) of the Constitution. Although this right may be limited in terms of section 36, such limitation would be unjustifiable **as** the purpose of the limitation – namely, the purpose of promoting a stable banking sector and public confidence in the banking sector – is not rational.

30. The authors of the opinion emphasize [at paragraph 55] that the argument based on arbitrary differentiation and rationality "is a demanding one that is by no means guaranteed of success."

31. The opinion then turns to the **arbitrary deprivation of property** argument; in other words, whether the Bill is consistent with section 25(1) of the Constitution. In this regard the opinion focuses on whether the deprivation of property of the Subordinated Noteholders is **proportionate** to the purpose of the Bill; namely, promoting confidence in, or the stability of, the banking sector. The focus is thus on the substantive fairness or sufficient reason. Again the opinion finds that on certain facts it is possible that the Minister may make a decision based on his or her opinion that inequitable treatment of creditors will promote the maintenance of a stable banking sector or public confidence in the banking sector, "and where such an opinion is at variance with the facts but is not vitiated by a reviewable irregularity" [at par. 61].

32. In respect of the second relevant amendment – i.e. raise funds on behalf of the bank, including raising security over the bank's assets, notwithstanding any contractual obligations of the bank – the opinion finds that it is **arguable** that the provision authorises arbitrary deprivation of property. The opinion refers to the lack of guidance given in the Bill on how the curator should exercise this power [at par. 65]. Be that as it may, the authors of the opinion emphasise that a finding on its constitutionality will depend on the facts – especially the reasons advanced by the curator and whether there are less restrictive means available – to justify the deprivation of property.

**National Treasury's opinion 2**

33. The second opinion procured by National Treasury is based on an amended version of the Bill, which includes the recommendations made in the first opinion. The proposals include:

- the reference to the Registrar in the provision authorising that the disposal or transfer of assets and liabilities may proceed notwithstanding the inequitable treatment of creditors and the absence of the no-worse off scenario;
- the tailoring of the provision allowing the curator to raise funds on behalf of the bank, including raising security over the bank's assets, notwithstanding any contractual obligations of the bank so that funds can only be raised from the Reserve Bank;
- explicit reference to the application of PAJA; and
- explicit reference to the retrospective application of the Bill.

34. The second opinion repeats many of the arguments made in the first opinion. For the purpose of this memorandum, I will deal with the relevant parts that concern the effect of the new provisions and the response to the Subordinated Noteholders' opinion.

35. The inclusion of the provision that all administrative action taken in terms of the Bill, including those of the curator, is subject to PAJA effectively deals with any objections that the deprivation of property – whether the approval of the disposal or transfer of assets that treats the creditors inequitably or the raising of funds on behalf of the bank, including raising security over the bank's assets, notwithstanding any contractual obligations of the bank – may be procedurally arbitrary [at par 22.7].

36. As to the sufficient reason for the deprivation of property in terms of the Bill, the opinion repeats that the reasons advanced in the Bill are weighty considerations and should pass constitutional muster. The question of **proportionality** is again answered by reference to court cases that found such a principle inherent in a "constitutionally-compliant interpretation" [at par 23.4.1]. In respect of both relevant amendments, the opinion finds that the Bill does not allow the arbitrary deprivation of property as prohibited by section 25(1) of the Constitution.

37. In respect of retrospective operation of the provisions of the Bill, the authors of the opinion again emphasise that in both our Constitution and foreign law, retrospective civil statutes are not, in itself, unconstitutional. The opinion states that "there is no general constitutional principle prohibiting retrospective [civil] laws" [at par. 30].

38. In response to the Subordinated Noteholders' opinion, the second opinion from National Treasury finds that the former "does not conclude that the Bill is necessarily or even likely unconstitutional" [at par. 33]. Instead, the Subordinated Noteholders' opinion finds it "arguable" that certain amendments are unconstitutional, but these arguments are by no means guaranteed of success. The success or otherwise of the arguments will depend on the reasons advanced by the Minister, Registrar or curator for exercising discretion in terms of the provisions of the Bill, in light of the provisions of PAJA.

39. In respect of the role of PAJA in hedging the application of the provisions of the Bill against arbitrary deprivation and consequently unconstitutionality of the action (not the Bill) the opinion notes that the Subordinated Noteholders' opinion does not deal with the judgment of the Supreme Court of Appeal of *Mobile Telephone Networks (Pty) Ltd v SMI Trading CC* 2012 (6) SA 638 (SCA). It is this judgement that the both the opinions procured by National Treasury rely on when it finds that PAJA is a hedge against unconstitutionality.

40. The opinion further finds that the grounds for review in PAJA are so broad that the scenario in the Subordinated Noteholders' opinion that the Minister's (or Registrar's, if one includes the proposed amendment in the version under discussion) opinion that the inequitable treatment of creditors is reasonable likely to promote the maintenance of a stable banking sector or public confidence in the banking sector, "and where such an opinion is at variance with the facts but it is not vitiated by a reviewable irregularity" is very narrow. Even if this is possible, a Court will not find that "this very narrow scenario means that the [provision] violates section 25(1) of the Constitution", especially given the importance of the need for the curator to have these powers.

41. The opinion also finds that the reliance in the Subordinated Noteholders' opinion on section 1(c) and 9(1) of the Constitution – namely, the **rule of law** argument and the **arbitrary differentiation** between creditors – is not sustainable. The reason being that in 20 years of constitutional jurisprudence only two cases challenging legislation succeeded on these grounds – as oppose to a multitude of cases based on these grounds in respect of administrative decisions and the making of regulations. The opinion refers to a multitude of cases that failed to get across the rationality threshold.

42. Therefore, the opinion concludes, the Bill is consistent with the Constitution.

**Analysis**

43. Having had the advantage of reading all three opinions, as well as listening to the submissions made by Counsel for the Subordinated Noteholders to the Committee on 25 March 2015, the issues common to all in considering this Bill can be summarised as follows:

- section 25(1) of the Constitution prohibits arbitrary deprivation of property;
- the Constitution does not prohibit retrospective operation of civil statutes;
- the Bill authorises deprivation of property, including the authority of an already appointed curator and could thus be considered as retrospective operation; and
- there is disagreement whether such deprivation is arbitrary.

44. The issue of whether the deprivation allowed by the Bill is arbitrary turns on two points. The first is whether PAJA applies automatically or whether it should be

included in the Bill. The case law (*Mobile Telephone Networks* case) cited by the authors of the two opinions procured by National Treasury makes it clear that PAJA applies and hedges a law against arbitrary deprivation of property. As correctly pointed out by the said authors, the opinion procured by the Subordinated Noteholders does not deal with this judgment from the Supreme Court of Appeal. However, the Subordinated Noteholders' opinion refers to a Constitutional Court judgment that requires Parliament to take care to give adequate guidance when it drafts legislation that confers discretionary powers on officials that may limit constitutional rights (*Dawood v Minister of Home Affairs* 2000 (3) SA 936 (CC) at par. 48). As this judgement deals with a set of facts that occurred prior to the promulgation of PAJA, I am of the opinion that the relevance of this judgement must be considered in light of PAJA. In any event, the proposal from National Treasury to include an explicit reference to the application of PAJA addresses this issue.

45. However, the Subordinated Noteholders' opinion argues that even if PAJA is applicable, there might be instances where a decision is taken that turns out to be incorrect because the inequitable treatment of creditors does not in fact result in the promotion of the maintenance of a stable banking sector or public confidence in the banking sector. As is clear from this line of reasoning, the argument turns on a specific decision taken in terms of the powers conferred in the Bill rather than the Bill itself. The second opinion from National Treasury also deals with this narrow exception and argues that it is doubtful whether such an eventuality can be envisaged given the scope of the grounds for review provided for in PAJA. In the event that such an eventuality occurs, it is argued that it will not cause the Bill to fail constitutional muster.

46. The second issue is whether the Bill itself is irrational as it permits arbitrary deprivation of property. In this regard the issue of proportionality is discussed in the opinions.

47. I understand the argument from the Subordinated Noteholders as follows:

- The provision in the Bill authorises the Minister and the Registrar to allow a disposal or transfer of assets and liabilities of a bank under curatorship.
- This discretion of the Minister or Registrar may be exercised even if the report from the curator indicates the inequitable treatment of creditors and that some might be worse off than in a liquidation.
- The discretion may be exercised only if the Minister is of the opinion that it would be reasonably likely that such disposal or transfer will promote of the maintenance of a stable banking sector or public confidence in the banking sector.
- However, the inequitable treatment of creditors and the absence of the no worse-off scenario is inimical to the purpose of promoting a stable banking sector or public confidence in the banking sector.
- Therefore the provision is self-defeating.
- In other words, the inequitable treatment of creditors and putting creditors in a position worse off than they would have been in liquidation or winding-up undermines the purpose of promoting the maintenance of a stable banking sector or public confidence in the banking sector. Therefore the Bill is irrational and, it follows, unconstitutional.

48. The arguments from National Treasury refer to two issues in this regard: first that the threshold for irrationality is set very low by the Constitutional Court. It is

therefore very unlikely that the Court will find the reasons advanced by the Minister as so frivolous or disconnected from the purpose of the decision that the Bill is irrational. Secondly, that proportionality is required in any exercise of a discretion that limits rights and that interpreting a statute in a constitutional compliant way requires that the Minister keeps proportionality in sight when exercising his or her discretion. In any event, the opinions from National Treasury argue with reference to Constitutional Court judgments, the test for rationality is less strict than a "full and exacting proportionality examination" and depends on the facts of the case.

49. Two issues remain to be dealt with: the argument on equality before the law and the argument based on the rule of law.

50. The protection of equality before the law originates from section 9 of the Constitution. In my view the argument that creditors are not treated in accordance with this guarantee dovetails the rationality or irrationality argument above. The gist of this argument is that infringement of the right to equal protection and benefit of the law is not underpinned by a rational purpose. In my view this line of reasoning is more concerned with a decision taken in terms of the new provisions in the Bill than with the Bill itself. As indicated in the opinions from National Treasury, the functionaries (curator, Registrar and Minister) would have to obtain legal advice when exercising their discretion to prevent the decision to be successfully reviewed in terms of PAJA.

51. Concerning the rule of law argument, all the opinions agree that retrospective civil statutes are constitutionally permissible in foreign jurisdictions as well as in South Africa. Although the submissions by Counsel for the Subordinated Noteholders on 25 March 2015 indicated that the first opinion from National

Treasury does not deal with this argument, I indicated above that the opposite is in fact true. The opinions from National Treasury do not deal with this argument to the same extent as the opinion from the Subordinated Noteholders, but the point is addressed and the conclusion is that the retrospective application of the provisions of the Bill does not violate the rule of law.

52. In my view the rule of law argument has seldom been used in South African constitutional jurisprudence. Section 1(c) of the Constitution provides that the rule of law is one of the founding values of the Constitution. It therefore underpins the Constitution. The Constitutional Court, in a judgment where this provision was used to argue against the constitutionality of an Act, opined that the founding values "inform the interpretation of the Constitution and other law, and set positive standards with which all law must comply in order to be valid" [see *United Democratic Movement v President of the Republic of South Africa and Others (African Christian Democratic Party and Others Intervening ; Institute for Democracy in South Africa and Another as Amici Curiae)* (No 2) (CCT23/02) [2002] ZACC 21; 2003 (1) SA 495; 2002 (11) BCLR 1179 (4 October 2002) at par. 19] (hereinafter the '*UDM case*').

53. In the *UDM case* the Constitutional Court found that the Constitution "requires legislation to be rationally related to a legitimate government purpose. If not, it is inconsistent with the rule of law and invalid" [at par. 55]. In light of this judgment, I am of the view that the rationality argument and the rule of law argument overlap to an extent. Be that as it may, the Court in the *UDM case* referred to the judgment in the *Pharmaceutical Manufacturers Association of South Africa and Another: In re Ex parte President of the Republic of South Africa and Others* [2000 (2) SA 674 (CC); 2000 (3) BCLR 241 (CC) at paras 84-

5] where it was pointed out that rationality as a minimum requirement for the exercise of public power,

> "does not mean that the courts can or should substitute their opinions as to what is appropriate, for the opinions of those in whom the power has been vested. As long as the purpose sought to be achieved by the exercise of public power is within the authority of the functionary, and as long as the functionary's decision, viewed objectively, is rational, a court cannot interfere with the decision simply because it disagrees with it or considers that the power was exercised inappropriately."

54. The Court in the *UDM case* found that "[t]his applies also and possibly with greater force to the exercise by Parliament of the powers vested in it by the Constitution" [at par. 68].

**Advice**

55. I agree with the opinions procured by National Treasury, as indicated at the outset. Included in this is the view that the Subordinated Noteholders' opinion deals mostly with the constitutionality of the exercise of the powers provided for in the Bill. As the discretionary powers provided for in the Bill could certainly affect constitutional rights, the exercise of these powers must be guided by the provisions of PAJA. Therefore I recommend that the amendments to the Bill proposed by National Treasury be considered by the Committee.

Adv F S Jenkins
Senior Parliamentary Legal Adviser