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TO: **Mr K Magaxa, MP; Chairperson: Portfolio Committee on Public Enterprises**

FROM: **Constitutional and Legal Services Office**

DATE: **9 November 2022**

Ref. No. **200 - 2022**

SUBJECT: **Advice on oversight of state owned enterprises under business rescue and the regulatory framework for public-private partnerships**

Purpose

1. To advise the Portfolio Committee on Public Enterprises (the Committee) on the following matters:
   (a) How Parliament can exercise oversight over business rescue process of state-owned companies (SOEs)?
   (b) The legislation relating to Business Rescue and Liquidation processes, challenges and recommendations.
   (c) The legislative framework that prohibits state organs from collaborating or doing business together (public-public partnership) for the public good.

Oversight

2. The Committee is a committee of the National Assembly, established in terms of Rule 225 of the Rules of the National Assembly, 9th Edition ("the NA Rules").

3. The National Assembly, and by extension its committees, is mandated by the Constitution of the Republic of South Africa, 1996 ("the Constitution") to hold the national executive to account. Accountability is one of the founding values of the Constitution. Section 1(d) of the Constitution adopts a multi-party system of democratic government "to ensure accountability, responsiveness and openness". Section 41(1)(c) of the Constitution

provides that all spheres of government and all organs of state within each sphere must provide "effective, transparent, accountable and coherent government".

4. Section 55(2) of the Constitution imposes a duty on the National Assembly to provide for mechanisms to hold the national executive to account:

   "The National Assembly must provide for mechanisms -

   (a) to ensure that all executive organs of state in a national sphere of government are accountable to it; and
   (b) to maintain oversight of,
      (i) the exercise of national executive authority, including the implementation of legislation; and
      (ii) any organ of state."

5. Rule 227 of the NA Rules prescribes the role of portfolio committees, such as this Committee, in the performance of this oversight function. Rule 227(1)(b) provides, amongst others, as follows:

   "A portfolio committee must maintain oversight of –
   (i) the exercise within its portfolio of national executive authority, including the implementation of legislation,
   (ii) any executive organ of state falling within its portfolio,
   (iii) any constitutional institution falling within its portfolio, and
   (iv) any other body or institution in respect of which oversight was assigned to it;"

6. Rule 227(1)(c) goes on to say that a portfolio committee:

   "may monitor, investigate, enquire into and make recommendations concerning any such executive organ of state, constitutional institution or other body or institution, including the legislative programme, budget, rationalisation, restructuring, functioning, organisation, structure, staff and policies of such organ of state, institution or other body or institution;"

7. The Oversight and Accountability Model adopted by Parliament defines oversight as follows: (See ATC, 27 January 2009.)

   "It follows that oversight entails the informal and formal, watchful, strategic and structured scrutiny exercised by legislatures in respect of the implementation of laws, the application of the budget, and the strict observance of statutes and the Constitution. In addition, and most importantly, it entails overseeing the effective management of government departments by individual members of Cabinet in pursuit of improved service delivery for the achievement of a better quality of life for all citizens."

Business rescue proceedings[1]

8. Chapter 6 of the Companies Act, 2008 (Act No. 71 of 2008) regulates business rescue proceedings.

9. Business rescue proceedings are proceedings aimed to facilitate the rehabilitation of a company that is financially distressed by providing for the following:

   (a) The temporary supervision of the company, and the management of its affairs, business and property, by a business rescue practitioner;
   (b) a temporary moratorium (stay) on the rights of claimants against the company or in respect of property in its possession; and
   (c) the development and implementation, if approved, of a business rescue plan to rescue the company by restructuring its business, property, debt, affairs, other liabilities and equity (section 128(1)(b)).

10. The purposes of business rescue plans are to restructure the affairs of a company in such a way that either maximizes the likelihood of the company continuing in existence on a solvent basis or results in a better return for the creditors of the company than would ordinarily result from the liquidation of the company (section 128(1)(b)(iii)).

[1] https://www.werksmans.com/legal-updates-and-opinions/the-status-of-business-rescue-in-south-africa/?gclid=CjwKCAiA9qKbBhAzEiwAS4yeDVvRIIlT0E1wuCEDAuoECjzhU6kvN9ojiVf5BLdvtsAVQTZAPdlTPxoCf6UQAvD_BwE . (Accessed 7 November 2022.)

11. A **business rescue practitioner** is a person appointed, or two or more persons jointly appointed, to oversee a company during business rescue. The word “person” in the Act includes a juristic person. It is therefore arguable that a company can take appointment as a business rescues practitioner (section 128(1)(d)).

12. **Affected persons** are important role players in the business rescue process. An affected person is a shareholder, creditor, employee (or their representative) or a registered trade union representing employees of the company. Affected persons have various rights throughout the business rescue process (section 128(1)(a)).

13. Based on the statistics from the Companies and Intellectual Property Commission (CIPC), there are 1,658 active business rescue proceedings in the country, which represents 39% of all business rescue proceedings commenced as at 31 December 2021. About 18% of business rescue proceedings have resulted in their respective business rescue plans being substantially implemented, whilst only 511 ended up in liquidation. Most business rescues, however, end by way of the filing of notices of termination by the respective business rescue practitioner.

14. The overwhelming majority of companies that make use of the business rescue mechanism are private companies. As at 31 December 2021, private companies made up 69% of the companies that were placed into business rescue proceedings. Since business rescue’s inception, only 97 public companies (2%) and 3 state-owned companies (0.07%) were placed under business rescue supervision. It must be noted, however, that during the 2021-2022 period, only 257 companies were placed into business rescue. This number is significantly less than the 373 business rescues, recorded during both the 2019-2020 and 2020-2021 periods. Provinces Majority of business rescue filings occur in Gauteng, followed by the Western Cape and Mpumalanga.

15. Section 132 provides for the duration of business rescue proceedings. Business rescue proceedings begin when:

    (a) the company—

    (i) files a resolution to place itself under supervision in terms of section 129 (3); or

(ii) applies to the court for consent to file a resolution in terms of section 129 (5) (b);

(b) an affected person applies to the court for an order placing the company under supervision in terms of section 131 (1); or

(c) a court makes an order placing a company under supervision during the course of liquidation proceedings, or proceedings to enforce a security interest, as contemplated in section 131 (7).

(2) Business rescue proceedings end when—

(a) the court –

(i) sets aside the resolution or order that began those proceedings; or

(ii) has converted the proceedings to liquidation proceedings;

(b) the practitioner has filed with the Commission a notice of the termination of business rescue proceedings; or

(c) a business rescue plan has been—

(i) proposed and rejected in terms of Part D of this Chapter, and no affected person has acted to extend the proceedings in any manner contemplated in section 153; or

(ii) adopted in terms of Part D of this Chapter, and the practitioner has subsequently filed a notice of substantial implementation of that plan.

16. Business rescue proceedings:

(a) Suspends liquidation proceedings (section 131(6));

(b) Suspends legal proceedings (including enforcement action or in relation to any property belonging to the company) against the company, unless authorised by the practitioner, with leave of the court, criminal proceedings are exempted as well as those of regulatory authorities (section 133(1));

(c) Property may be disposed of in the ordinary course of business (section 134);

(d) Each director of the company must continue to exercise the functions of a director, subject to the authority of the practitioner (section 137(2)), but is relieved of certain duties (see section 76) and liabilities (see section 77);

(e) The business rescue practitioner has full management control of the company in substitution of its board and pre-existing management, but may delegate any power or function to a person who was part of the board or pre-existing management of the company (section 140(a & (b));

(f) The practitioner may remove or appoint persons from or to the management of the company (section 140(c));

(g) The practitioner must develop a business rescue plan and implement the plan once adopted (sections 140(d), 150, 152);

(h) The practitioner is an officer of the court and must report to the court; and, has the responsibilities, duties and liabilities of a director of the company (section 140(2)).

17. Creditors and shareholders are affected persons and have rights during the business rescue proceedings to oppose the application, or to make the application for business rescue (sections 130 & 131); the remuneration of the practitioner (section 143(4)); and the business rescue plan (section 146).

Oversight over business rescue process of state-owned companies

18. The Oversight and Accountability Model does not provide a specific mechanism for oversight of SOEs. Be that as it may, the committees of the National Assembly must exercise oversight of the SOEs and in this regard are authorised to request any person to appear before it to give evidence or to produce documents.

19. During business rescue proceedings the Board of the Company still functions, subject to the authority of the practitioner. The practitioner takes the authority of the Board. Both these persons may be called to give evidence of the progress with the implementation of the business rescue plan, but the practitioner would be best placed to answer question in most instances.

20. Creditors and shareholders have a meaningful role to play in business rescue proceedings. In the case of SOEs, the shareholder is usually the state, represented by the relevant Minister as the Executive Authority. Committees may also call upon these persons to give evidence on the role they played during the business rescue proceedings, whether it relates to approval of the business rescue plan, the appointment of the practitioner or the remuneration of the practitioner.

Liquidation proceedings

21. The test for placing a company in liquidation, in short, is that it cannot pay its debts as they fall due.

22. According to the current law of South Africa, the winding-up of solvent and insolvent companies is regulated by separate Acts. The winding-up of solvent companies is governed by the Companies Act, while the winding-up of insolvent companies is governed by the Insolvency Act 24 of 1936 (Insolvency Act) and the Companies Act 61 of 1973 (Old Companies Act). For the purpose of this memorandum of advice, the assumption is that the opinion, in this section, deals with SOEs that cannot pay their debt as they fall due.

23. A company may be liquidated either voluntarily, by means of the board of directors passing a resolution to that effect, or an application can be made to court either by the company itself (a shareholders' resolution is required) or by a creditor or shareholder of the company. In most instances a court application is brought either by the company or a creditor on the basis that the company is unable to pay its debts as they fall due. The application is made on affidavit under oath in the court having jurisdiction in the area where the company has its registered address. The practice differs from division to division (i.e. in different parts of the country).[2]

24. Once a company is placed in liquidation it ceases to trade unless continued trading is necessary in the best interests of all creditors (e.g. because the liquidators want to sell the business as a going concern or because certain contracts need to be continued with in order to generate funds for creditors). Continued trading must be sanctioned either by the court or by creditors and shareholders.

25. Section 4 of the Companies Act provides for a "Solvency and liquidity test." The test is satisfied at a particular time if, considering all reasonably foreseeable financial circumstances of the company at that time

    (a) the assets of the company, as fairly valued, equal or exceed the liabilities of the company, as fairly valued; and

[2] https://www.bowmanslaw.com/wp-content/uploads/2019/11/Liquidation-Business-Rescue-and-Compromise-in-South-Africa.pdf (Last accessed on 8 November 2022.)

(b) it appears that the company will be able to pay its debts as they become due in the ordinary course of business for a period of 12 months after the date on which the test is considered; or in the case of a distribution (transfer of securities or shares, etc.) contemplated in paragraph (a) of the definition of “distribution” in section 1, 12 months following that distribution.

26. The solvency and liquidity test subsection (1) is based on, amongst others, accounting records and financial statements that satisfy the requirements of sections 28 and 29 of the Act.

27. Section 22 of the Companies Act prohibits reckless trading. It provides that a company must not carry on its business recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose. Furthermore, a company may not trade if it is unable to pay its debts as they become due and payable in the normal course of business. The CIPC may issue a notice to the company to show cause why the company should be permitted to continue carrying on its business, or to trade, as the case may be.

28. Sections 28 and 29 deal with the content and format of accounting records and financial statements. Section 30 provides that annual financial statements must be audited. Subsection (3) of section 30 provides that the annual financial statements of a company must include an auditor’s report, if the statements are audited; and, include a report by the directors with respect to the state of affairs, the business and profit or loss of the company, or of the group of companies, amongst others. The annual financial statements must be approved by the board and signed by an authorised director; and be presented to the first shareholders meeting after the statements have been approved by the board.

29. In the case of a SOE, such as South African Airways, the issue of liquidation as a result of failing the solvency and liquidity test did not arise as the board did not approve the annual financial statements prior to the shareholder; namely, the Minister of Finance at the time, providing additional liquidity.

Legislative framework for public-public partnership

30. Section 40 of the Constitution of the Republic of South Africa, 1996 (the Constitution) provides that the government is constituted as national, provincial and local spheres of government which are distinctive, interdependent and interrelated. Subsection (2)

provides that all spheres of government must observe and adhere to the principles in this Chapter and must conduct their activities within the parameters that the Chapter provides.

31. Section 41 provides the “Principles of co-operative government and intergovernmental relations” and specifies in paragraph (h) that all spheres of government and all organs of state within each sphere must co-operate with one another in mutual trust and good faith by-
    (i) fostering friendly relations;
    (ii) assisting and supporting one another;
    (iii) informing one another of, and consulting one another on, matters of common interest;
    (iv) co-ordinating their actions and legislation with one another;
    (v) adhering to agreed procedures; and
    (vi) avoiding legal proceedings against one another.

32. I am not aware of any statutory restrictions on organs of stare co-operating for the public good. Even if there were such statutes, these would probably be found to be unconstitutional.

33. We so advise.

Adv F S Jenkins

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