

# LEGAL FRAMEWORK OF SOE BOARDS





# TOWARDS TRANSPARENCY AND QUALITY IN SOE BOARD APPOINTMENTS

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# A.

## ABOUT THE PROJECT

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The Dullah Omar Institute is conducting research and advocacy on the framework for the appointment and dismissal of Board members to state-owned enterprises (SOEs). This is informed by a need for greater transparency and quality in these appointments.

The overall purpose is an improved functioning of SOEs that have a service delivery mandate or a mandate that impacts on a constitutional right. In particular, we want to see an improved accountability structure for the executive leadership of, legislative oversight over and public engagement with those SOEs.

SOEs are enterprises where the state has significant control through full, majority, or significant minority ownership. The research focuses on two key flaws in the appointment and dismissal of SOE board members. The first relates to procedural issues but is embedded in bigger questions surrounding the role and position of SOEs. In practice, board members are appointed by the relevant shareholder Minister in processes that are not transparent. Partly as a result of the conflicting legislative framework, procedures for the appointment of SOE board members often lack integrity, do not provide for adequate public engagement and take place without any communication to the South African public about the role of SOEs and the importance of the appointment processes. The second flaw relates to substantive criteria for appointment. Too often, there is a disjuncture between the fiduciary duties of SOE board members and the profile, skills and expertise of incumbents, pointing to inadequate criteria for appointment and dismissal or inadequate application of those.

Our aim is to suggest options for law reform, criteria for board membership and criteria for appointment processes that recognise the role of the public in these appointments. Our objective is to complement the existing activities of other civil society organisations in this space.

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# TABLE OF CONTENTS

<b>ABSTRACT</b>	<b>PG 01</b>
<hr/>	
<b>01. INTRODUCTION</b>	<b>PG 03</b>
<hr/>	
<b>02. GENERAL LEGAL FRAMEWORK GOVERNING NATIONAL SOEs IN SOUTH AFRICA</b>	<b>PG 05</b>
<b>2.1 Applicable legislation</b>	<b>PG 05</b>
2.1.1 Constitution of South Africa 1996	PG 05
2.1.2 SOE founding legislation	PG 06
2.1.3 Public Finance Management Act 1 of 1999 (PFMA)	PG 06
2.1.4 Companies Act 61 of 1973	PG 07
2.1.5 Companies Act 71 of 2008 (2008 Act)	PG 07
<hr/>	
<b>2.2 Applicable voluntary codes</b>	<b>PG 08</b>
2.2.1 Protocol on Corporate Governance in the Public Sector	PG 08
2.2.2 King III Report and Code on Corporate Governance for South Africa 2009	PG 09
2.2.3 King IV Report and Code on Corporate Governance for South Africa 2016	PG 09
<hr/>	
<b>2.3 Supremacy of legislation</b>	<b>PG 09</b>
<hr/>	
<b>03. LEGISLATIVE FRAMEWORK GOVERNING BOARD APPOINTMENTS, DISMISSALS AND RESPONSIBILITIES IN SOEs</b>	<b>PG 10</b>
<hr/>	

<b>3.1 Public Finance Management Act 1 of 1999</b>	<b>PG 11</b>
<b>3.1.1 Appointment, dismissal and qualification of boards         and executives</b>	<b>PG 11</b>
<b>3.1.2 Duties and liabilities of board members</b>	<b>PG 11</b>
<b>3.1.3 Audit Committees</b>	<b>PG 14</b>
<hr/>	
<b>3.2 Companies Act 71 of 2008</b>	<b>PG 14</b>
<b>3.2.1 Appointment, dismissal and qualification of boards         and executives</b>	<b>PG 14</b>
<b>3.2.2 Duties and liabilities of board members</b>	<b>PG 17</b>
<b>3.2.3 Audit Committee</b>	<b>PG 18</b>
<hr/>	
<b>3.3 SOE FOUNDING LEGISLATION</b>	<b>PG 18</b>
<hr/>	
<b>04. CODES OF CONDUCT GOVERNING SOEs</b>	<b>PG 24</b>
<hr/>	
<b>4.1 Protocol on Corporate Governance in the Public Sector</b>	<b>PG 25</b>
<b>4.1.1 Appointment, dismissal and qualification of boards         and executives</b>	<b>PG 25</b>
<b>4.1.2 Duties and liabilities of board members</b>	<b>PG 26</b>
<hr/>	
<b>4.2 King Report and Code on Corporate Governance for     South Africa 2009 (King III)</b>	<b>PG 26</b>
<hr/>	
<b>4.3 King Report on Corporate Governance for South Africa     2016 (King IV)</b>	<b>PG 27</b>
<hr/>	
<b>05. PRC REPORT AND SUGGESTIONS FOR REFORM</b>	<b>PG 32</b>
<hr/>	
<b>5.1 PRC report and recommendations</b>	<b>PG 32</b>
<hr/>	
<b>5.2 Current developments and suggestions for reform</b>	<b>PG 35</b>
<b>5.2.1 Appointment and dismissal of board members and executives</b>	<b>PG 35</b>
<hr/>	
<b>5.3 Strengthened financial oversight</b>	<b>PG 36</b>
<hr/>	
<b>06. FINAL REMARKS</b>	<b>PG 38</b>
<hr/>	

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# THE LEGAL FRAMEWORK

## FOR THE APPOINTMENT AND DISMISSAL OF SOE BOARD MEMBERS

**“The financial and governance failures of South African SOEs have been directly attributed to the existence of a convoluted legal framework comprising of overlapping and often conflicting legislation.”**

*Prof R Wandrag*

### ABSTRACT

State-owned Entities (SOEs) can play an important role in economic development and the welfare of emerging markets, provided that they are well-governed and managed and are not a drain on the national fiscus.

In South Africa, unfortunately many SOEs have proven to be a burden on government funds by repeatedly requesting and receiving financial bail-outs. The poor governance and financial failure of prominent SOEs, such as Eskom, reportedly contributed to South Africa's rating downgrades in recent years and has resulted in a Presidential Review Committee of state-owned entities (PRC), established by former President Zuma in May 2010. The committee's final report was accepted by Cabinet on 30 April 2013. The PRC advanced 31 recommendations for the reform of SOE governance and financial management, none of which have been implemented as yet.

The financial and governance failures of South African SOEs have been directly attributed to the existence of a convoluted legal framework comprising of overlapping and often conflicting legislation. At a national level, SOEs are governed by the following legislation and voluntary codes of conduct:

- Public Finance Management Act 1 of 1999
- SOE specific founding legislation
- Companies Act 71 of 2008
- Protocol on Corporate Governance in the Public Sector
- King IV Code and Report on Corporate Governance

To a large extent, these legal instruments govern different aspects of the SOEs' existence, but the one area in which these acts are often at odds with one another, is governance, and specifically the appointment and dismissal of board members and executives.

South African courts have failed to provide clarity on the supremacy of applicable legislation by providing contradictory decisions on similar facts, but different founding legislation.

This discord has left the boards of major SOEs, such as Eskom, SABC, PRASA and Denel, in disarray and it certainly created opportunities for corruption and state capture, as evidenced by the Public Protector's "State of Capture Report". This in turn certainly contributed to the dire financial state of SOEs, with prominent SOEs such as the SABC no longer being a "going concern" and being reported as "commercially insolvent".

One of the key recommendations from the PRC is the promulgation of one overarching "SOE Act" that must apply to all SOEs, including State-owned Companies (SOCs), and must override any other legislation currently applicable to these entities. The Department of Public Enterprises, as the department responsible for 6 major SOEs, including Eskom, Denel and PRASA, has been tasked to take the lead on the development of this act and has been promising to table it in Parliament since the publication of the PRC report. The same undertaking has been given for 2018.

The PRC recommendations also include the standardisation of board and executive appointments and dismissals, following "transparent and merit-based recruitment processes".

This report supports the promulgation of such an overarching SOE Act, as well as the suggestions for standardising board and executive appointments. These should not simply be the prerogative of the cabinet member (executive authority) responsible for the relevant SOE, but should be the primary responsibility of the board, who should recommend their preferred candidates, after a public and transparent nomination/recruitment process. Selections should be done on merit and suitability for and knowledge of the specific sector. Appointments should be confirmed by the National Assembly as representative of the public, who constitutes one of the most important SOE stakeholders.

In addition to the strengthening and clarification of the rules regarding board and executive appointments and dismissals, financial oversight over SOEs must be strengthened. This was made clear in President Ramaphosa's first State Of The Nation address, and seems likely to be done via the Draft Public Audit Amendment Bill of 2018 which is currently being debated. This Bill intends to enhance the powers of the Auditor General to not only render findings on the audited financial statements of SOEs, but to also refer undesirable audit outcomes for investigation and to possibly issue debt certificates to be collected by appropriate authorities.



## 01

## INTRODUCTION

**“State-owned entities can generally be defined as legal entities created by the government in order to partake in commercial activities on the government’s behalf.”**

“Efficiency. Competitiveness. Innovation. Integrity.

Do these words come to mind when you think of State-owned Enterprises?”<sup>2</sup>

Well-governed and managed state-owned entities (SOEs)<sup>3</sup> play an important role in economic growth and development, particularly in developing economies. The International Finance Corporation (IFC) has stated that the “importance of SOEs to the economies and welfare of emerging markets cannot be overestimated in Africa”.<sup>4</sup> However, the same article continues to state that “running SOEs well represents a significant challenge”.<sup>5</sup>

This has certainly been very true in South Africa. The rating agency Standard & Poor specifically mentioned the poor governance of SOEs in their reasons for downgrading South Africa to ‘junk’ status in April 2017, referring to SOEs ‘posing a risk to the country’s fiscal outlook’.<sup>6</sup> In this regard, they specifically referred to the need for governance reforms in SOEs, and highlighted the fact that Eskom at that stage still had to complete board appointments and appoint a permanent Chief Executive Officer (CEO). The reality is that between 2010 and January 2018, Eskom had 7 different CEOs or acting CEOs, and numerous changes in the rest of the board membership, none of which inspired confidence. SOEs have also been implicated in state capture. Eskom appeared 193 times in the Public Protector’s “State of Capture” report published in November 2016.<sup>7</sup> Another SOE implicated in the State of Capture report was PRASA. In addition to allegations of fraud, mismanagement and state capture, many SOEs are facing severe financial difficulties and have received, or requested repeated financial bail-outs from the SA government, including Eskom, SAA, Denel and the SABC.<sup>8</sup>

<sup>2</sup> Weiner, F. (2015) ‘4 key challenges for reforming State-owned enterprises: Lessons from Latin-America’ Governance for Development <http://blogs.worldbank.org/governance> [Accessed 18 March 2018].

<sup>3</sup> In this paper, the term State-Owned Entities (SOEs) will be used to refer to SOEs in general, unless a quoted source specifically used the term State-owned enterprises. The terms ‘entity’ and ‘enterprise’ in this context do not signify any difference in legal form and are often used interchangeably. State-Owned Companies (SOCs) on the other hand only refer to those SOEs that are also incorporated in terms of the Companies Act 71 of 2008. The term SOCs will be used to refer to these companies in the context of the application of the 2008 Companies Act.

<sup>4</sup> Armstrong, P. (2015) ‘Corporate Governance and State-owned Enterprises’ Ethical Boardroom <https://ethicalboardroom.com/corporate-governance-and-soes> [Accessed 16 March 2016].

<sup>5</sup> Armstrong, P. (2015)

<sup>6</sup> “What the rating Agency said about SA” Business Live 4 April 2017 <https://www.businesslive.co.za/rdm/business/2017-04-04-what-the-rating-agency-said-about-sa/> [Accessed 5 May 2017].

<sup>7</sup> Eberhard, A. and Godinho, C. (2017) Eskom Inquiry Reference Book University of Cape Town Graduate School of Business

<sup>8</sup> See various reports on <https://www.businesslive.co.za>

This continued dismal performance of, and public scandals relating to, the governance of many South African SOEs over the last number of years has resulted in a Presidential Review Committee of state-owned entities (PRC). Former President Zuma established the PRC on 12 May 2010. The committee's final report, accepted by Cabinet on 30 April 2013, includes 31 recommendations for the reform of SOE governance – none of which have been implemented as yet.<sup>9</sup>

State-owned entities can generally be defined as legal entities created by the government in order to partake in commercial activities on the government's behalf. The Organisation for Economic Development (OECD) defines SOEs as 'any corporate entity recognised by national law as an enterprise, and in which the state exercises ownership'.<sup>10</sup> In South Africa, such entities can be created across all three levels of government (national, provincial and municipal) and can be either wholly or partially owned or controlled by any of these spheres of government.

As indicated above, much of the controversy surrounding SOEs centres on governance issues, specifically the appointment and dismissal of board members and executives. This report will thus focus on the legal framework governing national SOEs, with specific reference to the applicable powers, processes and oversight mechanisms governing board and executive appointments and dismissals.<sup>11</sup> The governance controversies have certainly contributed to facilitating corruption, state capture and irregular expenditure, all which have led to prominent SOEs no longer qualifying as "going concerns"<sup>12</sup> and being commercially insolvent. This report will therefore also briefly reflect on the need for stronger financial oversight over the activities of SOEs.

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<sup>9</sup> Presidential Review Committee on State-owned State-owned Entities (2013) 'Growing the Economy – Bridging the Gap' <https://www.gov.za/sites/www.gov.za/files/presreview.pdf> [Accessed 16 March 2016]. These recommendations will be discussed in further detail below.

<sup>10</sup> OECD (2015) 'Guidelines on Corporate Governance of State-owned State-owned Enterprises' (2015) <http://www.oecd.org/corporate/guidelines-corporate-governance-SOEs.htm> [Accessed 10 March 2016].

<sup>11</sup> The legal frameworks governing provincial and municipal SOEs (although similar) will not be discussed in this paper.

<sup>12</sup> "Exclusive: Eskom is 'not a going concern'" Business Live 16 January 2018 <https://www.businesslive.co.za/bd/companies/energy/2018-01-16-exclusive-eskom-is-not-a-going-concern/> [Accessed 10 March 2018]; Merten, M. 2017 Auditor-General Report: Financial health of State-owned Entities flails amid ballooning irregular expenditure" Daily Maverick 1 November 2017 <https://www.dailymaverick.co.za/article/2017-11-01-2017-auditor-general-report-financial-health-of-State-owned-entities-flails-amid-ballooning-irreg%E2%80%A6#.WukgCy5ubgw> [Accessed 25 April 2018].

## 02

# GENERAL LEGAL FRAMEWORK GOVERNING NATIONAL SOEs IN SOUTH AFRICA

As at the end of May 2012, a consolidated database revealed 715 SOEs in South Africa across all spheres of government (including some non-commercial entities).<sup>13</sup> These entities are governed by a number of different Acts and voluntary codes of conduct, depending on how they were created.

## 2.1 Applicable legislation

### 2.1.1 Constitution of South Africa 1996:

- Section 55(2) requires the National Assembly (NA) to provide for a mechanism to ensure that all national executives are accountable to it and to maintain oversight over such national executive authorities. Section 42(3) empowers the NA to scrutinise and oversee executive action. Section 92(3)(b) stipulates that members of Cabinet must report fully to Parliament concerning matters under their control.
- Giving effect to the above mandate would require the NA to maintain oversight over 35 national departments and more than 200 national SOEs – an impossible task. Parliamentary policy and portfolio committees are therefore established to assist the National Assembly in this oversight function.
- The Standing Committee on Public Accounts (Scopa) fulfils the mandate of financial oversight by scrutinising the audit reports submitted by the Auditor General (AG). Portfolio Committees review the non-financial annual reports of the departments and SOEs.
- In terms of section 188 of the Constitution, the AG must audit and report to the NA on the accounts, financial statements and management of all national departments and entities.<sup>14</sup>
- The constitutional framework within which SOEs, and specifically the SABC operates, was highlighted in the *SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others; SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others*.<sup>15</sup>

<sup>13</sup> PRC report (2013) Vol 1\_3

<sup>14</sup> Note that the AG does not directly audit all national SOEs. Some SOEs, including Denel, Transnet and Eskom, are audited by private audit firms in accordance with AG directives and methodologies. See PFMA 2016-2017 Consolidated General Report <http://www.agsa.co.za/Reporting/PFMAReports/PFMA2016-2017.aspx> [Accessed 25 April 2018].

Judge Matojane specifically noted the requirement in section 192 that an independent authority must be created to regulate broadcasting in the public interest (ICASA). He also emphasised the independence of the SABC in terms of the right to freedom of expression in section 16 of the Constitution.<sup>16</sup>

### 2.1.2 SOE founding legislation:

The majority of national SOEs were created by their own constitutive legislation, for example the Broadcasting Act 4 of 1999 (SABC), the South African Airways Act 5 of 2007 (SAA), the Legal Succession to the South African Transport Services Act 9 of 1989 (PRASA) and the Eskom Conversion Act 13 of 2001 (Eskom).<sup>17</sup>

This founding legislation typically provides for the establishment of the SOE, and determines its mandate, functions and funding mechanisms. Some of the founding legislation, such as the Broadcasting Act 4 of 1999, contains detailed provisions on board appointments and processes, whereas the Eskom Conversion Act 13 of 2001 provides for the conversion of Eskom into a public company in terms of the Companies Act 61 of 1973, but contains no reference to the board of directors at all. Founding legislation is entity specific and can therefore not be discussed in general. Where relevant, specific founding legislation will be referred to in order to illustrate the current problems with SOE governance.

### 2.1.3 Public Finance Management Act 1 of 1999 (PFMA):

- The financial affairs and accounting responsibilities, of all 'public entities' listed in Schedules 2 and 3 of the PFMA are governed by this legislation.
- A national public entity is primarily defined in section 1 as "a national government business enterprise".
- A "national government business enterprise" on the other hand is defined as an entity which is a juristic person under the ownership control of the national executive, is carrying on a business activity on ordinary business principles and is largely or fully funded from sources other than from government funds.

<sup>15</sup> (81056/14) [2017] ZAGPJHC 289 (17 October 2017)

<sup>16</sup> This case will be discussed in more detail in reference to the appointment and removal of the board of the SABC.

<sup>17</sup> Denel SOC Ltd is one of the few exceptions in this regard. It was not created by founding legislation, but incorporated in 1992 as a private company with the government as only shareholder, in terms of the Companies Act 61 of 1973.

- “Ownership and control”, in relation to an SOE refers to the ability of the national executive (minister of the relevant department)
  - o to appoint or remove all, or the majority of, the members of that SOEs board of directors;
  - o to appoint or remove that entity’s chief executive officer (CEO);
  - o to cast all, or the majority of, the votes at meetings of that board of directors; or
  - o to control all, or the majority of, voting rights at a general meeting (AGM) of the SOE.
- Schedule 2 lists ‘Major Public Entities’ including ACSA, Denel, Eskom, SAA and the SABC. Schedule 3 lists a number of ‘Other Public Entities’, including national entities.

### **2.1.4 Companies Act 61 of 1973:**

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- This Act did not provide for the incorporation of SOEs as a separate company form, but many SOEs were incorporated as public companies in terms of this Act.
- State-owned entities that were incorporated as such, but now resort under the definition of State-owned Companies (SOCs) in terms of section 1 of the Companies Act 71 of 2008 are now governed by the 2008 Act.
- In terms of Schedule 5 of the 2008 Act, these companies are deemed to have amended their Memoranda of Incorporation (MOIs) to change their names in compliance with the requirements of the 2008 Act as from 1 May 2011, for example Airports Company South Africa Ltd is deemed to have changed its name to Airports Company South AfricaSOC Ltd (‘ACSA’).

### **2.1.5 Companies Act 71 of 2008 (2008 Act):**

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- The 2008 Companies Act provides for State-owned Companies (SOCs)<sup>18</sup> as a distinct company form.
- State-owned companies are classified as profit companies in terms of section 8 of the Act.

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<sup>18</sup> As explained above, in this paper, the term SOC will be used in relation to the specific requirements of the Companies Act 2008 as applicable to registered SOCs. The term SOE will continue to be used for more general reference, including references to national public entities in terms of the PFMA.

- A profit company is defined in section 1 as a 'company incorporated for the purpose of financial gain for its shareholders'. Per definition, the shareholder, or at least the majority shareholder in a SOC, will be the government.
- The specific organ of government that will be the designated shareholder depends on the specific nature of the SOC, but will typically be the cabinet minister responsible for the relevant department.
- An SOC is defined in section 1 as an enterprise that is registered in terms of the Companies Act as a company, and it includes those entities listed as public entities in Schedule 2 or 3 of the PFMA, for example Eskom and the SABC.
- The Companies Act 2008 will thus only apply to those national SOEs, governed by the PFMA, that are also registered as companies in terms of the 2008 Act, or previously registered as companies in terms of the 1973 Act and now complying with the definition of SOCs in section 1 of the 2008 Act.
- In terms of section 9 of the 2008 Act, any provision applicable to public companies also applies to SOCs, unless the Minister has granted an exemption.
- Such exemptions may be requested by the member of Cabinet responsible for SOCs or local government matters, for specific or classes of SOCs, on the basis of overlap or duplication with other legislation. The Minister may only grant such exemptions to the extent that the alternative legislation ensures the achievement of the purposes of the Companies Act to the same extent as the latter, and subject to limits and conditions that will ensure the achievement of said purposes. In other words, the minister should only grant an SOC an exemption from specific provisions in the 2008 Companies Act if the same result is being achieved by different legislation.

## 2.2 Applicable voluntary codes

### 2.2.1 Protocol on Corporate Governance in the Public Sector:

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- This Protocol was first published in 1999 in an attempt to instil good corporate governance in SOEs as part of the government's overall strategic vision to restructure SOEs.
- It was substantially revised in 2002 to include the principles embodied in the King II report and released in September of that year by the Department of Public Enterprises.

- The protocol was adopted by Cabinet in 2003, but it was never enacted or updated.
- This Protocol is applicable as a code of best practice for all public entities listed in Schedules 2 and 3 of the PFMA.

### **2.2.2 King III Report and Code on Corporate Governance for South Africa 2009:**

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- The King Codes provide detailed corporate governance guidelines to companies and other entities, but is voluntary in nature. These codes are only binding on companies listed on the Johannesburg Stock Exchange.
- King III applied to all entities regardless of the manner and form of incorporation or establishment, including SOEs and specifically SOCs up until 31 March 2017.

### **2.2.3 King IV Report and Code on Corporate Governance for South Africa 2016:**

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- King IV is effective in respect of financial years commencing on or after 1 April 2017 and has replaced King III in its entirety.
- King IV applies to all entities, regardless of form or manner of establishment and includes a specific sector supplement for the governance of SOEs, including SOCs. Like its predecessors, King IV is binding on companies listed on the JSE.<sup>19</sup>

## **2.3 Supremacy of legislation:**

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There is no uniform regulation of national SOEs in South Africa. All or some of the legislation and codes above regulate various aspects of SOE activities. In some instances, more than one piece of legislation may be applicable to the same aspect of governance of a given SOE. This is particularly relevant for SOCs that are governed by the 2008 Companies Act in addition to the PFMA and their own founding legislation. The different legal regimes are not aligned and conflicting provisions, particularly in relation to the appointment and dismissal of board members, have been challenged in court, as will be discussed below.

In some instances the legislation itself provides guidance as to which rules should prevail, but even these have not been interpreted uniformly.

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<sup>19</sup> Dlamini, S JSE makes King IV provisions mandatory for listed entities Business Report 22 June 2017 <https://www.iol.co.za/business-report/jse-makes-king-iv-provisions-mandatory-for-listed-entities-9915866>

Section 3(3) of the PFMA stipulates that in the event of any conflict between provisions of this Act and any other legislation, the provisions of the PFMA will prevail. This is confirmed by section 5 of the 2008 Companies Act, which stipulates that in the event of inconsistency between the Companies Act and any other Act, the provisions of both Acts will apply concurrently, to the extent that it is possible, and if it is not possible to apply both without contravening one, then any such provisions of the PFMA will prevail. The same rule does, however, not apply to conflicts between the Companies Act and SOE founding legislation. Section 5 of the 2008 Companies Act indicates that in the event of conflict with any act other than those listed (such as the PFMA), the Companies Act will prevail. In terms of the 2008 Companies Act, it should thus be the prevailing law in the event of a conflict with SOE founding legislation.<sup>20</sup> An entity such as the South African Broadcasting Corporation SOC Ltd (SABC), is thus governed by its founding legislation, the Broadcasting Act 4 of 1999, the PFMA, the 2008 Companies Act (as it is a registered company, and also listed as a public entity under Schedule 2 of the PFMA), the Protocol on Corporate Governance and as of 1 April 2017, King IV. The same position will apply in relation to the many of the national SOEs that are also registered companies, including the six SOCs resorting under the purview of the Department of Public Enterprises (SA Express, Eskom, Alexkor, Denel, SAFCOL and Transnet). SOEs that have not been incorporated in terms of the Companies Act as well, such as The Passenger Rail Agency of South Africa (PRASA), will thus be governed “only” by their founding legislation, the Legal Succession to the South African Transport Services Act 9 of 1989, the PFMA, the Protocol and King IV.

This plethora of applicable legislation has caused several problems in the governance of state-owned companies, and particularly the SABC, as will be highlighted below. The uncertainty created by overlapping and conflicting legislative regimes, is exacerbated by the apparent failure in parliamentary oversight and lack of public accountability, as illustrated by the examples discussed below.

# 03

## LEGISLATIVE FRAMEWORK GOVERNING BOARD APPOINTMENTS, DISMISSALS AND RESPONSIBILITIES IN SOEs

**“Such “ownership control” is evidenced by the ability of the executive authority (the cabinet minister accountable to Parliament for the specific national department) to appoint or remove board members and executives or to control majority voting in board or general meetings of the SOEs under its control.”**

<sup>20</sup> Note that the court in the SOS case differed from this interpretation. The judge found that the Broadcasting Act, as the more specific legislation, would prevail over the Companies Act 2008 in relation to removal of directors. See discussion below.



## 3.1 Public Finance Management Act 1 of 1999

The PFMA is applicable to all public entities listed in Schedules 2 and 3. These include national SOEs such as Eskom, Denel, the SABC and SAA.

### 3.1.1 Appointment, dismissal and qualification of boards and executives

The PFMA is primarily aimed at regulating the financial reporting structures and responsibilities of national public entities.

However, as indicated above, national SOEs are by definition under “ownership control” of the national executive. Section 63 of the PFMA provides that the executive authority (Cabinet Minister) responsible for such a SOE under national ownership control, must exercise the ownership control powers to ensure that the SOE complies with the PFMA and the financial policies of that executive.

Such “ownership control” is evidenced by the ability of the executive authority (the cabinet minister accountable to Parliament for the specific national department) to appoint or remove board members and executives or to control majority voting in board or general meetings of the SOEs under its control.<sup>21</sup> This definition has been interpreted as empowering the relevant cabinet minister to appoint the CEO and board members - ‘Board and CEO appointments are the responsibility of the Government as a shareholder’.<sup>22</sup>

Section 49 of the PFMA requires every SOE to have an accounting authority that will be accountable for purposes of the PFMA. It states that if the SOE has a board of directors, such board will be the accounting authority and therefore the accountable entity for purposes of the Act. In the absence of a board or controlling body, the CEO will be the accounting authority. The PFMA does not contain any provisions governing the appointment, removal or qualifications of board members or executives.

### 3.1.2 Duties and liabilities of board members

Section 50 of the PFMA continues to detail the fiduciary duties of such boards of directors, in language that largely corresponds with the common law fiduciary duties of directors in company law.

<sup>21</sup> This definition of control is reflective of the position of a sole or majority shareholder in a public company, but it does not take into account the complexities of the government’s triplicate role in SOEs. This will be explained further below.

<sup>22</sup> PRC ‘G&O Discussion paper: Oversight’ 22 March 2012

These duties include:

- the duty of utmost care to ensure reasonable protection of the assets and records of the SOE;
- acting with fidelity, honesty, integrity and in the best interests of the SOE entity in managing the financial affairs of the SOE;
- disclosing, on request, all material facts, including those reasonably discoverable, which in any way may influence the decisions or actions of the executive authority or legislature;
- Board members, may not act in a way that is inconsistent with the responsibilities assigned to the board in terms of the PFMA; or
- use the position or privileges of, or confidential information obtained as, board members, for personal gain or to improperly benefit another person.
- Board members must disclose to the board any direct or indirect personal or private business interest that they, or any spouse, partner or close family member may have in any matter before the board;<sup>23</sup> and
- may not participate in the proceedings of the board when that matter is considered, unless the board decides that the member's direct or indirect interest in the matter is trivial or irrelevant.

Section 51 of the PFMA sets out the general duties of the board in managing the business of the entity in much more detail than the equivalent requirement in section 66 of the Companies Act. These include ensuring effective risk management systems, submissions of returns and reports, compliance with tax and other laws.

Section 52 requires the submission of annual budgets and corporate plans to the relevant executive authority. Section 55 stipulates the submission of annual financial statements to the auditors within two months of the end of the financial year, and the submission of an annual report, plus audited annual financial statements and the auditor's report to the executive authority (and AG if they did not perform the audit) within five months of the end of the financial year.<sup>24</sup> As per the Constitutional requirements mentioned above, section 65 requires the relevant executive authority to table these annual reports and financial statements at the National Assembly.

Section 83 labels the wilful or negligent failure to comply with any requirement of sections 50 to 55 as an "act of financial misconduct" by SOE boards. The same applies to making or permitting irregular expenditure or fruitless and wasteful expenditure.

<sup>23</sup> Former Eskom executive Matshela Koko's actions in relation to contracts awarded to a company in which his stepdaughter was involved, is a prime example of a breach of these duties. See Mazonne, N. "Go, go Koko" The Messenger 16 February 2018 <http://www.themessenger.global/2018/02/16/go-go-koko/> [Accessed 10 March 2018].

<sup>24</sup> A number of SOEs have been guilty of not submitting these returns on time, including SAA. See PFMA 2016-2017 Consolidated General Report <http://www.agsa.co.za/Reporting/PFMAReports/PFMA2016-2017.aspx> [Accessed 25 April 2018] and Merten, M. 2017 Auditor-General Report: Financial health of State-owned Entities flails amid ballooning irregular expenditure" Daily Maverick 1 November 2017 <https://www.dailymaverick.co.za/article/2017-11-01-2017-auditor-general-report-financial-health-of-State-owned-entities-flails-amid-ballooning-irreg%E2%80%A6#.WukgCySubgw> [Accessed 25 April 2018].

Where the SOE has a board, every member (director) will be individually liable for any such financial misconduct of the accounting authority.<sup>25</sup>

Such financial misconduct is a ground for dismissal or suspension of, or other sanction against, a member of the board. In addition to dismissal or suspension, section 86 also provides for criminal sanctions, and stipulates that a board is guilty of an offence and liable on conviction to a fine, or to imprisonment for a period not exceeding five years, if that board wilfully or in a grossly negligent way fails to comply with a provision of sections 50, 51 or 55.

The act does not provide any guidance on the interpretation of the tests for wilful actions by the board. Section 86 only refers to the board (accounting authority) as a whole, thus it is not clear whether individual board members could be held criminally liable for breaches of their duties. It is equally unclear how a “board” could be sentenced to imprisonment – would this mean that all board members will be imprisoned for up to five years?

Although the fiduciary duties of board members in terms of section 50 of the PFMA correspond largely to the common law duties of company directors, they do not in all instances correspond to the now partially codified duties of directors as set out in section 76 of the 2008 Companies Act.

This is a point of caution, in view of the supremacy of the PFMA, in the event of inconsistencies between the two pieces of legislation that cannot be applied concurrently. For example, the PFMA does not contain any provision similar to the so-called business judgment rule in section 76(4) of the Companies Act.

The so-called<sup>26</sup> business judgment rule in section 76(4) of the Companies Act prevents courts from second-guessing the decisions of directors who took reasonable steps to inform themselves of the matter, who either had no financial interest in the matter, or declared any financial interest and who had a rational basis for believing, and did believe, that the decision was in the best interest of the company. Such directors will be deemed to have fulfilled their duties of care, skill and diligence and will not be liable for any damages that may have resulted from their decision.

Should it be found that the provisions in the two Acts regarding duties of directors cannot be applied concurrently, the PFMA will apply and the directors of the SOC will not enjoy the protection of the business judgment rule.

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<sup>25</sup> Irregular expenditure is one of the main reasons for qualified SOE audits. The AG reported R687 million in irregular expenditure by the SABC alone in the 2016-17 financial year, with the South African Post Office incurring R719 million in irregular expenditure – in both cases largely due to improper procurement and bidding processes. See Merten, M. 2017.

<sup>26</sup> Termed “so-called” is used because the section resembles the American Business Judgement Rule, but it is not termed as such in the 2008 Companies Act.

In terms of possible concurrent application, directors of SOCs who are in breach of their duties of care, skill and diligence, but comply with the requirements of section 76(4), may escape personal liability for damages caused due to breach of these duties, but may still be held liable for financial misconduct in terms of the PFMA for breach of the fiduciary duty of good faith (fidelity, honesty and integrity, acting in the best interest of the SOE) and other duties listed in section 50 of the PFMA. Board members of SOEs that are not registered companies (such as PRASA) will not have any option of protection in terms of the business judgment rule, and should face the consequences of section 83 of the PFMA for breaches of their duties.

### 3.1.3 Audit Committees

In terms of the PFMA and National Treasury Regulations, the board must appoint the audit committee, whereas section 94 of the Companies Act requires such appointments to be done at the AGM. The PFMA and National Treasury Regulations contain detailed duties and reporting requirements for audit committees, which again, will prevail over the provisions of the Companies Act in the event of inconsistencies and the impossibility of concurrent application.

## 3.2 Companies Act 71 of 2008

### 3.2.1 Appointment, dismissal and qualification of boards and executives

In terms of section 66 of the Companies Act, the business of an SOC must be managed by or under the direction of its board, which must comprise of at least three directors. The board has the authority to exercise all of the powers and perform any of the functions of the company. The provisions relating to the appointment, duties, removal and liability of directors apply to the boards of SOCs, in as far as these are not inconsistent with provisions of the PFMA or with provisions in the SOE founding legislation.

Directors of SOCs as profit companies shall be elected by way of voting at the AGM, unless the Memorandum of Incorporation (MOI)<sup>27</sup> provides otherwise. Contrary to other profit companies, there is no requirement that at least 50% of the directors must be elected by shareholders.

<sup>27</sup> The MOI is the constituting document of the SOC, filed with the Companies and Intellectual Property Commission (CIPC) at incorporation. This document details the rights, duties and responsibilities of shareholders, directors and others within and in relation to the company, and other matters as contemplated in section 15 of the Act. These may include matters not regulated in the Act, restrictions on the company or directors and it may include more onerous / higher requirements than the Act itself contains in relation to certain decisions of the company and may include a prohibition on amendments of the MOI. The MOI may not contain provisions that are contrary to the Act itself.

By nature, the sole or majority shareholder of SOCs is the government. Shareholding is typically assigned to a particular ministry and exercised by the relevant minister in relation to a specific SOC. The relevant minister will thus exercise these voting rights and elect all board members in practice. This provision suits the nature of shareholding in typical profit companies, where the role of shareholders is limited to exercising voting rights in general meetings. This provision does not however take into account the triplicate role played by the government in relation to SOCs. In addition to being the only or majority shareholder in the company, the relevant government department is also the policy maker concerned with implementation of service delivery. At the same time it also serves as regulator and exercises oversight in being the entity responsible for reporting on the SOCs' activities to the NA.

The Companies Act does not deal directly with the appointment of executives such as the Chief Executive Officer (CEO), and this is in fact not a description found in the Companies Act. The appointment of such executives will however resort with the board as part of their function in running the business of the company in terms of section 66. Such executives will thus report to the Board, who will exercise oversight over their activities.

Where the government as shareholder in the SOC appoint both the board and the executives (as per the interpretation of the PFMA), executives will tend to report to the government shareholder, and the board will be sidelined and become ineffective (as numerous examples have shown).

Removal of directors is provided for in section 71 of the Companies Act. Irrespective of any stipulation in the MOI or any other agreements reached, any director can be removed from the board by way of an ordinary majority shareholder vote, provided that the director had been given due notice of the meeting and the resolution and had been afforded a reasonable opportunity to make a presentation.

Again, in terms of the typical structure of the SOC, this will give the minister as the government shareholder representative the power to remove or dismiss members of the board by way of exercising a majority vote. Practice has proven that this is not a suitable stipulation in the SOC context either, as it leaves board members open to the will of an individual minister, without any oversight over his or her decisions. This has proven to leave SOC boards open to political interference (as evidenced in the State of Capture report). This section on the removal of board members may also conflict or overlap with the relevant requirements of the SOC founding legislation.<sup>28</sup>

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<sup>28</sup> See *Minister of Defence and Military Veterans v Motau and Others* 2014 (5) SA 69 (CC); *SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others*; *SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others*, (81056/14) [2017] ZAGPJHC 289 (17 October 2017).

There are no provisions in the Companies Act regarding any minimum requirements/qualifications for board members. Any such requirements or qualifications could, and should be written into the MOI of the company. It would be recommended that SOCs stipulate the requirements for suitable board members in their MOIs. There are however provisions in the Companies Act detailing the disqualification or ineligibility of directors.

The following categories of people/persons will be ineligible for board appointments: juristic persons, minors or persons who do not qualify in terms of any requirements in the MOI.

Disqualification on the other hand, will follow if a person has been prohibited from being a director or has been declared delinquent by a court.<sup>29</sup> The boards of a number of SOCs have in fact faced the risk of being declared delinquent or being placed under probation. On 16 September 2014, the CIPC informed the boards of SA Express Airways SOC Ltd, South African Forestry Company SOC Ltd (SACOL), the SABC SOC Ltd, the South African Post Office SOC Ltd and CEF SOC Ltd that they had to submit to the CIPC the mechanisms they had put in place to address the concerns raised by the AG or independent auditor in the 2012/13 annual reports. They were further informed that, should the CIPC not be satisfied with their progress, they may consider approaching the court to have any or all of the respective boards declared delinquent and placed under probation.<sup>30</sup>

Un-rehabilitated insolvents, persons prohibited from being directors by public regulation, and persons removed from an office of trust (e.g. trustee, or executor) for dishonest misconduct, or who have been convicted and sentenced to prison without a fine for theft, fraud, forgery or crimes related to fraud, dishonesty and misrepresentation in relation to company management are also disqualified from being directors. The disqualifications related to fraud and dishonesty will expire after five years. Again these provisions, although suited to the typical profit company, will not be enough to safeguard SOCs from inappropriate board appointments. There is nothing in the Companies Act dealing with the possible appointments of members of the judiciary, Members of Parliament or government officials to SOC boards. Unless such parties are prohibited from appointment by "public regulation", the only way to prevent their appointment would be disqualifications in the SOCs' MOI, or potential disqualifications in the SOC founding legislation. Also, board appointments in typical profit companies do not involve the public at large, whereas the public is a definite stakeholder in SOCs and should therefore have some input in SOC board appointments. This could be dictated in the SOC MOI, or again, in founding legislation, in the absence of a uniform legislative framework providing for public input.

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<sup>29</sup> In terms of s162 a court can declare a person delinquent in relation to misconduct and abuse of power while serving as director, serving as director while being ineligible, etc.

<sup>30</sup> "Media Statement No 2 of 214" 16 September 2014 [http://www.cipc.co.za/files/6514/1933/0901/Media\\_Statement\\_2\\_of\\_2014.pdf](http://www.cipc.co.za/files/6514/1933/0901/Media_Statement_2_of_2014.pdf) [Accessed 25 April 2018].

### 3.2.2 Duties and liabilities of board members

The common law fiduciary duties of directors and the duty of care and skill were partially codified in the Companies Act 2008, in that the Act stipulates the duties as found in the common law, without specifically replacing the common law. A new addition in this regard, is the so-called business judgment rule in section 76(4), which as stated above, provides protection to directors as if they have exercised the required care, skill and diligence, provided that they took steps to inform themselves, had no personal interest in the decision, had a rational reason to believe, and did believe, that the decision was in the best interest of the company. As noted above, this protection is not available to members of the board in terms of the PFMA. SOC Board members may still however face extensive liability in terms of section 77 of the Companies Act for breach of fiduciary duties and a number of other duties. This includes liability for being in agreement to carry on with the business of the company in contravention of section 22 of the Act. Section 22 prohibits the “reckless carrying on” of the business of the company. Carrying on with the business of the company while knowing that it is no longer a “going concern” may certainly lead to such liability. A number of SOCs are in fact no longer “going concerns” and their boards may therefore face liability in terms of sections 22 and 77.<sup>31</sup>

It should be noted that, although the Companies Act does not deal specifically with the positions of Chief Executive Officer (CEO) or Chief Financial Officer (CFO), such positions should resort under the description of a “prescribed officer” in sections 76 and 77. As such, the CEO and CFO would share the same fiduciary duties, duties of care and skill and potential liabilities as that of board members.

As indicated above, the role of government as shareholder, the appointment and dismissal processes for board members of SOCs, do not fit neatly within the general provisions regarding the role of shareholders and the functions of the board in the Companies Act. In many instances, other applicable legislation, such as the PFMA, or SOE founding legislation, contains conflicting provisions regarding the appointment and removal of board members and the CEO. In the current state of affairs in South Africa these conflicting provisions have caused some of the most vexing problems with regard to the governance of SOCs.

As referred to above, the position is further complicated in that government is not only the shareholder or majority shareholder in state-owned companies, but also the policymaker determining the policies directing the activities of SOCs, as well as the overseer/regulator responsible for implementing these policies.

<sup>31</sup> “Exclusive: Eskom is ‘not a going concern’” Business Live 16 January 2018 <https://www.businesslive.co.za/bd/companies/energy/2018-01-16-exclusive-eskom-is-not-a-going-concern/> [Accessed 10 March 2018].

These different, but overlapping and often conflicting roles of government in relation to state-owned companies are not clearly defined or separated in any of the governing Acts, as also highlighted in the final report of the PRC.<sup>32</sup>

### 3.2.3 Audit Committee

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Chapter 3 of the Companies Act requires enhanced standards of accountability and transparency from certain types and forms of companies based on the level of public interest in the affairs of the company. These enhanced standards also apply to SOCs, unless exempted as described above, or where these enhanced provisions conflict with the provisions of the Public Audit Act 25 of 2004, in which case the latter will prevail.

Every SOC must appoint an audit committee of at least three board members. The first members of the audit committee may be appointed by the incorporators, or by the board, within 40 days after incorporation. Subsequent members of the audit committee must be appointed annually at the AGM. Such members of the audit committee must be directors who satisfy any minimum requirements prescribed by the Minister and who are not directly involved in the day-to-day management of the company, who are not prescribed officers or full-time employees of the company, who are not material suppliers or customers of the company, or related to any of the above persons. In essence, the requirement is that of an impartial, objective director who fulfils any minimum qualification criteria prescribed by the Minister.

## 3.3 SOE FOUNDING LEGISLATION

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As indicated above, the majority of national SOEs have been created in terms of their own founding (enabling) legislation, such as the SABC being created by the Broadcasting Act 4 of 1999.

SOEs' founding legislation cannot be discussed in terms of generic application, as these are entity specific. Some founding legislation contains minimal provisions regarding the functioning of the SOE (such as the Eskom Conversion Act 13 of 2001), while others may contain detailed financial provisions (which will be overridden by the PFMA) or detailed provisions on the appointment, duties and removal of the board of directors (such as the Broadcasting Act 4 of 1999), which may conflict with the 2008 Companies Act, if applicable.

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<sup>32</sup> PRC report (2013) Vol 1\_8



Such conflicts have arisen in a number of SOEs already. In *Minister of Defence and Military Veterans v Motau and Others*<sup>33</sup> the Constitutional Court considered the dismissal of two board members from Armscor (Armaments Corporation of South Africa SOC Ltd) by the Minister of Defence, in terms of section 8 of the Armaments Corporation of South Africa Limited Act 51 of 2003. In terms of this section of the Armscor founding legislation, the Minister has the power to dismiss board members 'on good cause shown'. Judge Khampepe found that the Minister indeed had such good cause for dismissal in the particular circumstances.

However, Judge Khampepe also found that, as Armscor was an SOC in terms of the definition in section 8 of the 2008 Companies Act, the provisions of this Act relating to the removal of directors had to be applied concurrently with that of the founding legislation. Of particular relevance were the provisions of section 71(1) and (2), relating to the removal of directors by way of an ordinary resolution of shareholders, but only after the directors had been given notice of the meeting and resolution, and been given a reasonable opportunity to make presentations. It was common cause that the Minister did not comply with these procedural requirements.

Judge Khampepe found that although, as shareholder, the Minister could exercise the decision to remove the directors, she had to afford them the necessary notice and procedural fairness required by section 71(2) of the Companies Act.

Based on the specific circumstances of the case, the Court did not nullify the Minister's dismissal of the two directors due to her failure to comply with section 71 of the Companies Act. It did make a declaratory order relating to the unlawful nature of the Minister's actions in relation to her failure to comply with section 71 of the Companies Act, in conjunction with section 8 of the Armscor founding legislation. In this case the Court thus gave effect to the concurrent application of legislation as provided for in section 5 of the Companies Act.

Similar facts arose in *Molefe and Others v Minister of Transport and Others*<sup>34</sup> in relation to PRASA. The Passenger Rail Agency of South Africa (PRASA) is an SOE created in terms of section 22 of the Legal Succession to the South African Transport Services Act 9 of 1989 (Legal Succession Act). The main difference here is that this legal entity is purely a creation of the Legal Succession Act and is not incorporated in terms of the Companies Act. Section 31(2) of the Legal Succession Act specifically excludes the corporation from the application of the Companies Act. PRASA is thus governed by the Legal Succession Act and the PFMA (PRASA is a national government business enterprise listed under Schedule 3 of the PFMA).

<sup>33</sup> *Minister of Defence and Military Veterans v Motau and Others* 2014 (5) SA 69 (CC)

<sup>34</sup> *Molefe and Others v Minister of Transport and Others* (17748/17) [2017] ZAGPPHC 120 (10 April 2017)

The case concerned the decision taken on 8 March 2017 by the Minister of Transport to dissolve the PRASA board of control by removing the board members. The Minister removed the board members by sending notices to each of them, unilaterally terminating their directorship of PRASA with immediate effect.

As stated above in the text, the PFMA does not contain any stipulations on board appointments. Section 24 of the Legal Succession Act requires the affairs of PRASA to be managed by a board of control, to be appointed and dismissed by the Minister. This Act does not stipulate any specific procedures to be followed in such appointment or dismissal.

Judge Mabusa thus confirmed that the Minister had the power to dismiss the board members, but found that it is an unalienable principle of our law that everyone is entitled to present his or her case (the *audi alterim partem* rule). In this instance she did not afford the board members the opportunity of a fair hearing and, therefore, Judge Mabusa found the Minister's actions to have been unlawful, unreasonable, and so disproportionate as to be arbitrary and irrational. He therefore ordered the reinstatement of the board members that had been removed and set aside the appointments of the interim board members.

It should be noted that Judge Mabusa specifically referred to the *Motau* case, where the same finding was made, with the difference that Armscor is an SOC governed also by the Companies Act which requires such fair proceedings in the removal of directors.

The most recent and public instance of conflict between overlapping legislation relates to the SABC. The SABC was created by the Broadcasting Act 73 of 1976 and then converted into a limited liability company, with the government as the only shareholder in terms of the Broadcasting Act 4 of 1999, as amended. The Broadcasting Amendment Act 64 of 2002 specifically amended this founding legislation to state that, as from the date of conversion, the Companies Act applied to the SABC as if it was incorporated in terms of the latter, except those sections of the Companies Act specifically excluded in the Broadcasting Act (the sections excluded do not include the section dealing with removal of directors).

The SABC is thus governed by the Broadcasting Act of 1999, the Companies Act of 2008 as well as the PFMA (as a major public entity listed under Schedule 2).

The PFMA does not provide for the appointment or removal of board members. The Companies Act does provide for procedures to remove directors [section 71 and the company's Memorandum of Incorporation (MOI)]. Section 15 of the Broadcasting Act stipulates that the appointing body, which is the President on advice of the NA, may remove a board member upon a recommendation of the board, and must remove a board member upon a finding of a committee of the NA and adoption of such.

The then Minister of Communications, the Hon Faith Muthambi, representing the shareholding department, maintained that the Companies Act was the overriding legislation governing the removal of directors. She also contended that the SABC MOI had been revised to provide her, as shareholder, with the power to remove board members in terms of the Companies Act.

This led to an investigation by an ad hoc committee established by the National Assembly (NA), whose report was adopted by Parliament in March 2017. The committee found that this supposed amended MOI was never registered with the Companies and Intellectual Property Commission (CIPC) and was therefore not valid. All actions taken based on this supposed amended MOI were therefore invalid, including the removal of some board members.<sup>35</sup>

The committee also differed from the Minister in their interpretation of the applicable legislation, finding that general principles of law determine that the more specific legislation (Broadcasting Act) trumps the more general legislation (Companies Act) in the event of conflict. The committee therefore found that the removal of directors resides under the Broadcasting Act and remains the prerogative of the President, upon recommendation of the board or the NA. The committee recommended that the board be dissolved and an interim board be appointed.

It should be noted that this interpretation of the supremacy of the Broadcasting Act differs from that of the court in the *Motau* case, discussed above, which emphasised the concurrent application of SOC founding legislation and the Companies Act as far as possible. Contrary to the Broadcasting Act, the Armscor Act does grant the Minister the power to remove directors.

Judge Khampepe found that in terms of concurrent application of the founding legislation and the Companies Act, the minister's power should be exercised in conjunction with the procedural requirements of section 71 of the Companies Act.

The report from the ad hoc committee was adopted in March 2017, yet the appointment of permanent executive board members for the SABC has still not been finalised. Only the positions of Chief Operating Officer and Group Executive: News and Current Affairs have been filled, and the latter only in March 2018, after the matter went to court in late 2017. In *SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others; SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others*<sup>36</sup> the court dealt with two applications regarding the improper ministerial interference in the SABC board.

<sup>35</sup> Interim report of the ad hoc committee on the SABC board Inquiry into the fitness of the SABC board, dated 27 January 2017.

<sup>36</sup> 81056/14) [2017] ZAGPJHC 289 (17 October 2017)

It focused on the constitutionality and lawfulness of the powers the Minister exercises in respect of the appointment, discipline, suspension and removal of directors. The first application (SABC 1) concerned the Memorandum of Incorporation (MOI) of the SABC. During 2013, the then Minister of Communications, Minister Carrim, had properly filed changes to the SABC MOI. That version will for this discussion be referred to as the previous MOI. During 2014, Minister Muthambi signed a new amended MOI, granting her extensive powers in relation to the appointment of executive officers. The previous, 2013 MOI on the other hand, had granted the board the power to appoint executives.

SABC 1 thus focused on the so-called amended MOI and the extensive powers it confers on the Minister in respect of the appointment, discipline and suspension of the three SABC executive officers (the Group Chief Executive Officer, the Chief Operating Officer and the Chief Financial Officer). In terms of the amended MOI the Minister has veto power on these appointments and an unfettered discretion to manipulate the interview and shortlisting processes and essentially appoint his or her preferred candidates without advertising (as was done by former Minister Muthambi). The amended MOI also grants the Minister the power over the operations and administration of the SABC board in that it must seek the approval of the Minister if they wish to make rules relating to the governance of the SABC.

Whereas section 13 of the Broadcasting Act specifies that the non-executive members of the board must be appointed by the President on advice of the NA, it is silent on the appointment of the executive directors. The court dealt with this and Judge Matojane made it clear that section 13(11) stipulates that 'The Board controls the affairs of the Corporation'. He emphasised that the power to control the 'affairs' of the corporation indicates a wider power than merely controlling the 'business' of the corporation. He made it clear that this power to control the affairs of the corporation resorts with the board, and not with the Minister as shareholder. 'The effect of section 13(11) therefore is to confer on the Board the exclusive power to control the affairs of the SABC. The Minister is accordingly precluded from exercising any powers by which she may control the Directors in how they control the affairs of the SABC'.\*

Judge Matojane also examined the constitutional framework and indicated that the extensive powers to intervene in the operations of the SABC as per the amended MOI undermine the independence of the SABC as required by the right to freedom of expression (including the freedom of the media) in terms of section 16 of the Constitution of South Africa 1996. The clauses of the amended MOI conferring power on the Minister in relation to the executives of the SABC were declared to be inconsistent with the Broadcasting Act of 1999 and thus invalid.

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\* "At para 127."

The court order specified that 'the executive members of the Board are to be appointed solely by the non-executive members of the board and without any requirement of approval by the Minister'.<sup>37</sup> Such appointments are to be effected following a process which ensures transparency and openness, including public advertisements.

The second application (SABC 2) concerns the power of the Minister to remove the directors of the SABC. In this instance (as also discussed by the parliamentary committee mentioned above), the Minister contends that, as shareholder, she has the power to remove the directors in terms of section 71 of the Companies Act. In this instance the court agreed with the interpretation of the parliamentary committee in finding that the removal of directors of the SABC is governed by sections 15 and 15A of the Broadcasting Act, and not by the Companies Act. As discussed above, in terms of the Broadcasting Act, the power to remove directors rests with the National Assembly. Judge Matojane thus agreed with the interpretation that the Broadcasting Act, as the specific legislation enacted to govern the SABC, overrides the more general Companies Act. The judge noted that the Broadcasting Act is not listed under section 5(4)(b)(i) of the Companies Act, and that accordingly, none of the provisions of the Broadcasting Act is made applicable in the event of inconsistency with the Companies Act. He found this to undermine the independence of the SABC as required by the Constitution and thus declared the relevant provision of the Companies Act (section 71) to be invalid in relation to the SABC. Members of the SABC board can only be removed in compliance with sections 15(1) and (2) and 15(A) of the Broadcasting Act.

What is difficult to understand, is that the judgment in SABC 1 is based on the so-called amended MOI, which (as established by the parliamentary committee discussed above) was never lodged with the CIPC and was therefore never valid or in force to begin with. In November 2017, Minister Kubayi-Ngubane indicated her dissatisfaction with the judgment, indicating that, although she did not 'necessarily' oppose the ruling that the board should appoint executives, the board should at least consult with the minister.<sup>38</sup> On 6 December 2017, the Minister lodged an application for the rescission of the judgment as it had been 'discovered that an incorrect MOI had been placed before the court',<sup>39</sup> in that the court had based its judgment on the amended MOI, which was never filed (and was therefore not in effect). The minister contended that the SABC is in fact following the 'previous' MOI duly lodged in 2013, which grants the relevant appointment and removal powers to the board.

<sup>37</sup> *SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others; SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others*, (81056/14) [2017] ZAGPJHC 289 (17 October 2017); Phakathi B, Minister accepts ruling on SABC Business Day 20 June 2018 <http://tisobg.pressreader.com/business-day/20180620/281629600989996> [Accessed 20 June 2018]

<sup>38</sup> 'New legal battle looms over SABC' Business Live 8 November 2017 <https://www.businesslive.co.za/bd/national/media/2017-11-08-new-legal-battle-looms-over-sabc/>

<sup>39</sup> Briefing on the Memorandum of Incorporation (MOI) of the SABC Presentation to Portfolio Committee in Parliament 20 February 2018

An out of court settlement was reached in December 2017, in which the Minister had agreed to certain terms relating to the appointment of SABC executives that would safeguard the independence of the board. The interim court order thus stipulates that only the non-executive members of the board are permitted to appoint the executive members (COO, CF and GCEO). The interim order also states that the Minister has no right to veto any decision of the board relating to the appointment, interim or permanent, of an executive member. The final condition is that any such appointment must be done only after consultation with the Minister of Communications and therein lies the Minister's bone of contention. The order even specifies the type of consultation required, referring to the case of *The Premier, Western Cape v President of the Republic of South Africa*.<sup>40</sup> The consultation referred to in this case would mean that the SABC board had to consult with the Minister in the process of decision making, but would not be bound by her views as she has no veto power.

Minister Kubayi-Ngubane, however, remained of the opinion that she has to be consulted on the appointment of executives. During January 2018, news reports claimed that Mr Chris Maroleng had been appointed as COO by the SABC board and the Minister indicated that this had been done without consulting with her.<sup>41</sup> It appeared that at the time the appointment process had not been concluded, therefore the board still had time to 'consult' with her, but would not be bound by her opinion. On 30 January 2018, the SABC board officially announced the appointment of Chris Maroleng as the new COO with effect from 1 February 2018.<sup>42</sup> The SABC appointed Ms Phathiswa Magopeni as the Group Executive: News and Current Affairs effective from 01 March 2018.<sup>43</sup> Some of the other executive positions remain vacant.

# 04

## CODES OF CONDUCT GOVERNING SOEs

The provisions discussed above constitute the enforceable legal framework governing SOE board appointments and dismissals in South Africa. In addition to the legislative framework, SOEs are guided by codes of best practice. These remain voluntary in nature, with the exception of King IV being binding on companies listed on the JSE, as per the JSE listing rules.<sup>44</sup>

<sup>40</sup> 1999 (3) SA657 CC

<sup>41</sup> "Conditional offer" made to Chris Maroleng, SABC board confirms' News24 23 January 2018 <https://www.news24.com/SouthAfrica/News/conditional-offer-made-to-chris-maroleng-sabc-board-confirms-20180123> [Accessed 10 March 2018].

<sup>42</sup> 'Chris Maroleng officially appointed as SABC COO' News24 30 January 2018 <https://www.news24.com/SouthAfrica/News/chris-maroleng-officially-appointed-as-sabc-coo-20180130> [Accessed 10 March 2018].

<sup>43</sup> "SABC appoints GE for News and Current Affairs" SABC News 12 February 2018 <http://www.sabcnews.com/sabcnews/sabc-appoints-ge-news-current-affairs/> [Accessed 25 April 2018].

<sup>44</sup> Dlamini, S JSE makes King IV provisions mandatory for listed entities Business Report 22 June 2017 <https://www.iol.co.za/business-report/jse-makes-king-iv-provisions-mandatory-for-listed-entities-9915866>

# 4.1 Protocol on Corporate Governance in the Public Sector

## 4.1.1 Appointment, dismissal and qualification of boards and executives

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The Protocol, as adopted by Cabinet in 2003, emphasises the role of the SOE board and recommends that each SOE should be headed by an 'effective and efficient board' (article 5). It further provides that the board has absolute responsibility for the performance of the SOE and it should, in concurrence with the Minister, appoint the CEO.

Article 5.1.1.2 stipulates that the "board must retain full and effective control over the SOE and monitor management closely in implementing board plans and strategies".

In defiance of this bold statement, the Protocol then continues to follow the premise of the PFMA regarding the powers and role of the Minister in appointing the board and executives. It grants the executive authority the power to appoint the chairperson of the board as well as the chief executive officer, but in both cases only if not otherwise agreed in the shareholders' agreement or shareholder compact. The Protocol thus leaves open the possibility that someone other than the executive authority could be granted the power to appoint executives. It also provides that the executive authority should consult with the board about its preferred candidate for the position of CEO.

With reference to the appointment of directors, the Protocol simply provides "when appointing directors, the shareholder (Minister) should ensure that the board is properly constituted." Equally so, the shareholder (Minister) is given the power to remove or dismiss directors. It does however stipulate that the Minister should establish a Nomination Committee comprised of the CEO and Chairperson of each SOE to recommend the best qualified people to the Minister for board appointments.

The Protocol stresses the importance of non-executive directors on SOE boards and provides that they should be "individuals of calibre and credibility with the necessary skill, special expertise and knowledge" to exercise judgment independent of management. It also provides for the possible disqualification of directors on grounds of legal disability, insolvency or misconduct justifying removal from the office of trust, or a criminal record (for example for theft, fraud and forgery).

Contrary to the legislative frameworks discussed above, which does not provide for specific terms of office for boards, the Protocol provides for directors to serve a term of three years after which their appointments will expire. Due to the voluntary nature of the Protocol, this provision is however not enforceable.

### 4.1.2 Duties and liabilities of board members

The Protocol requires the shareholder minister to conclude a “performance contract” with the SOE board. This is called a “shareholder compact” and is defined as an agreement “regulating the relationship between the shareholder and the board”. In terms of article 5.1.12.1 of the Protocol this should “describe in as much detail as is reasonably possible the role and responsibilities of the board as a whole and of individual directors”.

The requirement for the conclusion of the shareholder compact is confirmed by Treasury regulation 29.2.1.<sup>45</sup> If executed properly, these compacts can serve as important measures of key performance areas to be achieved by the SOC. The Presidential Review Committee found, however, that these shareholder compacts “have not been successful in the oversight of SOEs”.<sup>46</sup>

The PRC came to this conclusion after extensive research, engagements and interviews with Government Institutions, Parliamentary Committees and SOEs. Reasons for this failure include the contractual nature of the compact that requires consensus between the executive authority and the SOE boards. This failure to reach consensus is closely linked to the unequal relationship of shareholder/owner and entity. Very often these shareholder compacts are not signed on time and make insufficient provision for objectives beyond narrow goals of profitability.<sup>47</sup> There is no evidence of government ever taking steps against any SOE board for failing to sign the shareholder compact, largely because it is mostly the government that fails to sign, and not the SOE.<sup>48</sup> Thus shareholder compacts have mostly failed as performance measurement / oversight tools.

This Protocol was never legislated; it thus remained a code of good conduct. It was also never updated to include the principles and changes embedded in the King III and King IV reports. It is therefore outdated in terms of corporate governance developments.

## 4.2 King Report and Code on Corporate Governance for South Africa 2009 (King III)

As previously stated, King III was the effective corporate governance regime governing all entities, irrespective of the manner and form of incorporation or establishment, including state-owned entities up until 31 March 2017. The King Codes also remain voluntary in nature, with the exception of listed entities, on whom the King reports are binding.

<sup>45</sup> Treasury Regulations for departments, constitutional institutions and public entities Issued in terms of the Public Finance Management Act, 1999.

<sup>46</sup> PRC ‘G&O Discussion paper: Oversight’ 22 March 2012 p.35.

<sup>47</sup> PRC ‘G&O Discussion paper: Oversight’ 22 March 2012 p.35.

<sup>48</sup> PRC ‘G&O Discussion paper: Oversight’ 22 March 2012 p.36.



King III was principle-based in that adherence to these principles would signify the practice of governance. King III adopted an 'apply or explain' governance framework. This entailed that where possible and practicable, SOCs were to apply and implement the principles and practices recommended by King III. Where the board believed it to be in the best interests of the company to adopt a different practice than that recommended by King III, it could do so, but had to explain it. If the different practice adopted could be explained and an acceptable reason provided for it, it would still result in consistency with King III principles.

As the framework recommended by King III was principle-based, there was no 'one size fits all' solution. All entities were not required to necessarily implement the same measures, but were encouraged to tailor the principles as appropriate to the size, nature and complexity of their organisations. This would also apply to SOCs. At the same time, however, there was nothing in King III that took particular cognisance of the peculiar nature of SOCs in terms of their mandate, their shareholding and the duplication of roles played by government.

## 4.3 King Report on Corporate Governance for South Africa 2016 (King IV)

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The most recent King Report on Corporate Governance (King IV) was published in November 2016. King IV became effective in respect of financial years commencing on or after 1 April 2017 and replaced King III in its entirety.

Like King III, King IV follows a principle and outcomes-based approach, but has moved from 'apply or explain' to 'apply and explain'. This approach assumes that all principles, being universal, are a given and have been applied. Companies, including state-owned entities, are expected to explain the practices implemented to give effect to these principles. The focus is on achieving the desired outcomes, and not specific processes.

King IV is based on a number of fundamental concepts, including 'integrated thinking'. This concept underpins the role of SOCs as an integral part of society, its role as a corporate citizen, and the principle of stakeholder inclusivity.

King IV recommends the establishment of a social and ethics committee for all entities, something which is already a legislative requirement for SOCs residing under the 2008 Companies Act. Section 72(4) of the 2008 Companies Act provides that the Minister may prescribe which companies must appoint a social and ethics committee, if it is desirable in the public interest. The number of employees, turnover and nature and extent of the company's activities may determine whether the company would be required to appoint such committee.

Companies Regulation 43 lists SOCs as one of the types of company that has to appoint a social and ethics committee. The functions of this committee include monitoring the SOC's activities in relation to social and economic development, good corporate citizenship, labour, health and public safety, the environment and to report to the shareholders on these matters.

King IV, however, recommends extending the role and functions of this committee to include matters pertaining to ethical behaviour and ethics management. It also proposes greater integration between this and other board committees.

One of the most important innovations in King IV is its formal recognition of the fact that different types and forms of enterprises may require different governance frameworks, and that certain aspects of King IV are more relevant to specific sectors than others. King IV therefore includes sector supplements containing more tailor-made guidelines for organisations from specific sectors, such as municipalities and state-owned entities.

In introducing the sector supplement for state-owned entities (including state-owned companies), King IV emphasises the important role of SOEs in creating the foundation of economic growth as highlighted by the Presidential Review Committee on state-owned entities, which declared that the state should 'preside over viable, efficient, effective and competitive SOEs'.

The sector supplement on state-owned entities applies to all public entities listed in Schedules 2 and 3 of the PFMA (including those registered as SOCs in terms of the Companies Act and regulated by the MFMA). Those municipal entities are, however, by definition companies, and would therefore reside under King IV in their capacity as companies. All state-owned companies should still strive to align with the principles of King IV.

In line with the requirements of the PFMA, the bulk of the governance obligations under King IV resides with the SOE / SOC board as detailed in the relevant principles listed below.

In terms of the sector supplement for state-owned entities, the principles of King IV apply as follows for SOEs (including SOCs):

1. The board should lead ethically and effectively. This is directly linked with section 195 of the Constitution of the Republic of South Africa 1996 that requires public administration to be governed by democratic values and principles enshrined in the Constitution, including a high standard of professional ethics.
2. The board should govern the ethics of the SOE in a way that supports the establishment of an ethical culture.

3. The board should ensure that the SOE is and is seen to be a responsible corporate citizen as by virtue of their public interest mandates. Corporate citizenship is core to the purpose of an SOE. Taxpayers fund SOEs and therefore SOEs are accountable to these citizens. Principle 3 should thus be applied by SOEs to give effect to their public interest mandates. As is clear from the legislative frameworks detailed above, there is in fact no provision for such accountability by SOEs to the citizens that fund it.
4. The board should appreciate that the SOE's core purpose, its risks and opportunities, strategy, business model, performance and sustainable development are all inseparable elements of the value creation process. SOEs should keep in mind the strategic development priorities of government and relevant policies set out by ministries relevant to specific SOEs.
5. The board should ensure that reports issued by the SOE enable stakeholders to make informed assessments of the SOE's performance and its short, medium and long-term prospects. Effective communication with stakeholders, such as the executive (shareholding government department) and taxpayers, is important and reports that are underpinned by integrated thinking play an important role in informing stakeholders.
6. The board should serve as the focal point and custodian of corporate governance in the SOE. The board should comply with the fiduciary and other responsibilities detailed in section 50 of the PFMA and where relevant, section 75 of the Companies Act.
7. The board should comprise the appropriate balance of knowledge, skills, experience, diversity and independence for it to discharge its governance role and responsibilities objectively and effectively. The composition of the board is thus very important, and the nomination and appointment process for members of the board is vitally important, including the role of the nominations committee. The SOE and the executive authority should be transparent regarding the processes followed for the nomination, election and appointment of board members. The executive authority and SOE should also agree on the staggered rotation of board members in order to introduce new skills, while maintaining continuity.
8. The board should ensure that its arrangements for delegation within its own structures promote independent judgement, and assist with the balance of power and the effective discharge of its duties.

9. The board should ensure that the evaluation of its own performance and that of its committees, its chair and its individual members, support continued improvement in its performance and effectiveness.
10. The board should ensure that the appointment of, and delegation to, management contribute to role clarity and the effective exercise of authority and responsibilities. King IV here recognises that in terms of SOE founding legislation and the PFMA, the executive (government department) has the power to appoint the CEO, and not the board. King IV recommends that this should be a robust and transparent process that involves the board to the greatest extent possible. It also recommends that agreement should be reached between the board and the executive shareholder, that the CEO be accountable to the board and that the latter has primary responsibility for the removal of the CEO.
11. The board should govern risk in a way that supports the SOE in setting and achieving its strategic objectives.
12. The board should govern technology and information in a way that supports the SOE setting and achieving its strategic objectives.
13. The board should govern compliance with applicable laws and adopted, non-binding rules, codes and standards in a way that supports the SOE being ethical and a good corporate citizen.
14. The board should ensure that the SOE remunerates fairly, responsibly and transparently so as to promote the achievement of strategic objectives and positive outcomes in the short, medium and long term.
15. The board should ensure that assurance services and functions enable an effective control environment, and that these support the integrity of information for internal decision makings and of the SOE's external reports.
16. In the execution of its governance role and responsibilities, the board should adopt a stakeholder-inclusive approach that balances the needs, interests and expectationsof material stakeholders in the best interests of the SOC over time.

In relation to principle 16, King IV highlights the importance of government as stakeholder in SOCs, but in so doing, it also inadvertently highlights one of the most problematic aspects of the governance of state-owned companies, the triplicate stakeholder role of government:

- o It is the shareholder (or majority shareholder) concerned with the financial viability of the SOC.
- o It is the industry policymaker overseeing implementation of service delivery.
- o It is the regulator concerned with regulating the industry practices of SOCs.

It rightly points out that these roles may overlap, and may even conflict with each other.

King IV recommends that the shareholder compact should be used to particularly clarify the roles of the board and the executive authority as shareholder. Generally, the executive authority should provide policy direction to the SOC, while the board should oversee implementation thereof. It further recommends that the shareholder compact should provide for alternative dispute resolution procedures in the event of a dispute about the interpretation of the compact.

The announcement of sector supplements as part of King IV was welcomed, in the hope that it would address some of the pressing concerns plaguing the governance of state-owned companies.

In some instances, such as in relation to principle 16 and the relationship between the SOC and government as stakeholder, King IV rightly recognises the governance problems, and makes reasonable suggestions as to how this should be addressed, e.g. through clear agreement on the roles of the executive and the board in the shareholder compact. It has, however, already been mentioned that in practice these shareholder compacts often do not fulfil their desired roles, due to being signed late and not being forward-thinking enough.

Even though King IV highlights the triplicate role of government as stakeholder in different capacities, and even recognises that these capacities may overlap and even conflict, it does not (and probably could not) provide a solution for this, one of the biggest problems in SOC governance.

Equally so, principles 7 and 10 set out the ideal position in relation to the nomination and appointment of board members, as well as the CEO. The reality is that this is difficult to achieve, as the nomination and appointment processes for boards of state-owned companies are not uniformly regulated.

In practice, board members are appointed by the relevant shareholder minister, ostensibly 'in consultation with cabinet'. There is, however, no clarity on exactly what such consultation entails in terms of process. Based on some of the controversial board appointments made to prominent state-owned companies in the last number of years, this practice is problematic. In the same vein, the King IV recommendations regarding the 'robust and transparent' process for the appointment of the CEO (which in terms of legislation is done by the executive shareholder) is far removed from current reality as evident from the SABC case discussed above. Current practice over the last decade did not provide for transparency or consultation in board and executive appointments. On the contrary, during this period board and executive appointments were often used for personal gain, and sadly in relation to state capture, as evident from the State of Capture report. There was sadly no evidence of the robust and transparent processes advocated by King IV.

# 05

## PRC REPORT AND SUGGESTIONS FOR REFORM

### 5.1 PRC report and recommendations

As indicated above, the Presidential Review Committee on State-owned Entities was established in May 2010 at a time that the chairperson called "characterised by enormous challenges and great opportunities".<sup>49</sup> The PRC, as per its executive summary, envisioned "a framework for SOE reforms and optimal contribution to equitable growth, development, transformation and service delivery in South Africa". In relation to governance, the PRC found the legislative framework for SOEs to be "inadequate, displaying evidence of conflict and duplication".<sup>50</sup> The same was found in relation to the governance, ownership policies, oversight systems and the quality of board recruitment. The PRC also specifically mentioned a lack of clarity on the role of the executive authority, boards and the CEO in the governance and operational management of SOEs – an aspect that has been clearly illustrated in the case studies above.

During its investigations, a number of subsidiary reports were drafted. These reports explored the legal framework governing SOEs in South Africa and reference was made to a number of policy documents that had already been drafted. One of these is the Centralised Shareholder Management Model (CSM), drafted by the Department of Public

<sup>49</sup> PRC (2013) Vol 1-1

<sup>50</sup> PRC (2013) Vol 1-8

Enterprises in 2010 as an internal discussion paper.<sup>51</sup> This paper highlighted the problems with overlapping legislation and specifically mentioned that 'it is worth distinguishing between Government's role as policy maker, custodian of national revenue fund, regulator and shareholder'.<sup>52</sup> This document was then also linked to the proposed Government Shareholder Management Bill (as a new 'SOE Act'). The CSM recommended that the new SOE Act should contain all provisions relating to SOE boards, including appointment, fiduciary duties, powers, etc. and that all board-related provisions should be removed from the PFMA. The Department of Public Enterprises has indicated that it was no longer pursuing the GSM Bill as the new SOE Act,<sup>53</sup> yet the CSM contained some very valuable principles.

The PRC report specifically commended the board appointment processes provided for in the Broadcasting Act,<sup>54</sup> which stipulates in section 13 that the twelve non-executive members of the board must be appointed by the President on the advice of the National Assembly. It further requires that the non-executive members of the Board must be appointed in a manner ensuring –

- (a) participation by the public in a nomination process;
- (b) transparency and openness; and
- (c) that a shortlist of candidates for appointment is published, taking into account the objects and principles of this Act.

It also provides that the President must designate two of the members of the board as the chairperson and a deputy chairperson, both of whom must be non-executive members of the board. This is a departure from the approach taken in the PFMA and the Protocol, but as clearly expressed by the court in the SOS cases, this is a necessary departure to ensure the independence and autonomous functioning of the SOE: 'The effect of section 13(11) therefore is to confer on the Board the exclusive power to control the affairs of the SABC. The Minister is accordingly precluded from exercising any powers by which she may control the Directors in how they control the affairs of the SABC.'<sup>56</sup> Unfortunately as seen above, the Broadcasting Act does not provide for the appointment of executives such as the COO.

The PRC's final report was adopted by Cabinet at the end of April 2013. It included 31 recommendations, as well as a time-line for the implementation of these recommendations, stretching into 2025.

<sup>51</sup> PRC "G&O Position Paper: Ownership" 5 March 2012 p.10.

<sup>52</sup> "G&O Position Paper: Ownership" 5 March 2012 p.11.

<sup>53</sup> PRC "Key Outcomes: Current SOE Legislative Frameworks & Impact" April 2012 p.28.

<sup>54</sup> Presidential Review Committee on State-owned State-owned Entities (2013) Vol 2 \_ 102.

<sup>55</sup> Both the PFMA and the Protocol vest the power to appoint the chairperson of the board as well as the chief executive officer in the executive authority (Minister).

<sup>56</sup> SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others; SOS Support Public Broadcasting Coalition and Others v South African Broadcasting Corporation SOC Limited and Others, (81056/14) [2017] ZAGPJHC 289 (17 October 2017) par 127.

These recommendations are wide-ranging, but with reference to governance, include the following:

- development of a long-term strategy for SOEs including the promulgation of a single 'SOE Act' that should apply to all SOEs across the government as a whole, should supersede all current legislation governing SOEs, should reduce the burden of compliance with a multitude of laws and regulations and should include a Corporate Governance Framework for SOEs;
- standardisation of board and executive appointment and remuneration processes for all SOEs, as well as standardising development and delivery goals; these appointment processes should follow a transparent and merit-based recruitment process; CEO appointments should be done by the Minister in concurrence with Cabinet, at the recommendation of the board, who would be responsible for recruitment of candidates;
- a re-examination of financing of SOEs (striking a better balance between equity and debt financing); and
- strengthening the political accountability of ministers over SOEs so as to ensure better line-function management.

Three years later, during his State Of The Nation address in February 2016, President Zuma announced interventions in the governance of SOEs as a result of the PRC report. A press statement released the following day confirmed that "for the state-owned companies to contribute to the successful implementation of the National Development Plan, they must be financially sound, be properly governed and managed". President Zuma stated, "We will ensure the implementation of the recommendations of the Presidential Review Commission on State-owned Enterprises, which outlines how the institutions should be managed."<sup>57</sup>

No real evidence has emerged of these "interventions". The Department of Public Enterprises (who is responsible for oversight on 6 main SOEs, including Eskom, Denel, PRASA and Transnet) has a distinct mandate of shareholder management in SOEs on behalf of the government. In the Budgetary Review and Recommendation Report (BRRR) of the Portfolio on Public Enterprises, dated November 2015, it is stated that the department had been tasked by Cabinet to play a leading role in the development of the governance framework that would ensure optimal management of SOCs (all 6 the SOEs reporting to the department are registered companies). The main outcome of this mandate was indicated as the proposed Government Shareholder Management Bill. The report indicated that work on this

<sup>57</sup> "President Jacob Zuma announces interventions of the State-owned State-owned Enterprises" 12 Feb 2016 <http://www.presidency.gov.za/press-statements/president-jacob-zuma-announces-interventions-State-owned-enterprises> [Accessed 10 March 2018].



Bill was nearing completion and that the Bill would be introduced in Parliament in 2016. That of course did not happen, and the same undertaking was given during presentations before the portfolio committee on 30 January 2018 – the department would “ensure that the Bill came before Parliament, subject to Cabinet's approval”. President Ramaphosa expressed the same expectation during his State of the Nation address in February 2018.

## 5.2 Current developments and suggestions for reform

President Ramaphosa, during his State of the Nation address, promised a complete overhaul of SOEs, referring to the steps taken to strengthen governance at Eskom, root out corruption and restore finances as “just the beginning”. He specifically referred to changes in the process of board appointments to ensure that people with the necessary expertise, experience and integrity are appointed.<sup>58</sup> He also referred to changes in the funding models of SOEs, hinting at a greater mix of debt and equity finance, as has been mentioned by the newly appointed Board Chair of Eskom, Jabu Mabuza.

As is clear from the above discussions, SOEs face numerous challenges, but the most important, and most often recurring, relate firstly to the appointment and removal of board members and executives, with specific reference to the role played by the responsible minister as shareholder representative, while also being the main policy driver and person responsible for oversight and secondly to the dismal state of SOE finances.

### 5.2.1 Appointment and dismissal of board members and executives

The only solution for the muddled practices around the nomination, appointment and removal of board members and executives of state-owned companies is uniform, overarching legislation that will regulate the position in all state-owned companies, as also recommended by the PRC. The PRC also recommends that the separate roles of government as owner (shareholder), policymaker, regulator and implementer should be clearly delineated.

This “SOE Act” must provide for clear and unambiguous recruitment and appointment processes for all executives and board members. It should include provisions on disciplinary measures and removal of board members and executives as well. These provisions should be aimed at retaining the independence of the board in terms of governing the affairs of the SOE and preventing undue ministerial interference in governance matters, while keeping intact the policy guidance and general oversight roles of the relevant ministry.

<sup>58</sup> ‘Ramaphosa vows SOEs will be overhauled, Sassa will meet deadline’ Business Live 16 February 2018 <https://www.businesslive.co.za/bd/national/2018-02-16-ramaphosa-vows-soes-will-be-overhauled-and-audit-processes-beefed-up/> [Accessed 10 March 2018].

These appointments should follow on a transparent and public process of board nominations. The recent SOS judgment provides valuable guidance in this regard, as does the stance expressed by Jabu Mabuza, emphasising firm boundaries between the board, management and the government. As per the statement of Judge Matojane quoted above, the board should have full control over the affairs of the SOE, which include board and executive appointments and dismissals. While the relevant minister should be consulted on the preferred candidates, final approval of appointments should not be within the power of the minister as shareholder, but should rest with the NA as representatives of the public, to whom SOEs owe a duty of accountability (as per King IV).

The SOE Act must also clearly provide for its supremacy over other legislation applicable to the relevant SOE. The PFMA does not regulate board appointments, but some of the SOE founding legislation does. In view of the SOS judgment, the SOE Act will have to clearly stipulate its supremacy over founding legislation in this regard. SOCs are also governed by the provisions in the Companies Act relating to the appointment/election and removal of directors. As seen from the case studies above, these provisions have proven to be problematic in SOE context, granting too much power to the minister in the capacity of shareholder. This could easily be solved by including the SOE Act in section 5(4)(b)(i) as one of the acts that will have supremacy over the Companies Act in the event of a conflict. This provision should be echoed in the SOE Act (as is the case with the PFMA). Provisions regarding the appointment of board members can also be stipulated in the MOIs of SOCs, but as clearly illustrated by the SABC debacle, this could be dangerous.

## 5.3 Strengthened financial oversight

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As mentioned above and is clear from regular news reports, a large number of SOEs are facing financial difficulties. A number of them are commercially insolvent, or at least no longer going concerns, face huge debt burdens and have received or applied for numerous government bailouts. Eskom reached the point in January 2018 where the JSE threatened to suspend trading in its bonds if it could not produce its interim results and the SOE faced the prospect of having to source refinance from international markets, provided its bonds were not suspended. An intervention at presidential level brought new hope with the announcement on 20 January of the appointment of businessman Jabu Mabuza as chairman of the Eskom board, and Phakamani Hadebe as acting group CEO. Mabuza is credited with having rescued Telkom from the brink of disaster.

Eskom finally released its interim results on 30 January 2018, staving off suspension from the JSE. It received lifelines from a consortium of banks, and a tide-over loan from the PIC. It still faces an uphill financial battle, especially after further credit rating downgrades by S & P. Chairman Mabuza has indicated that it may consider selling off assets and swapping debt for equity in the company. Very important from a governance point of view, is Mabuza's stance on the separation of the roles of the board, management and the government as shareholder. In his own words, "I don't employ, I don't procure. I don't sell. I don't collect debt."<sup>59</sup> This firm stance on the board's strategic role, guided by the mandate from government as shareholder, without interfering in the running of the company, assisted in the turnaround of Telkom.

The Companies Act provides for a business rescue process in terms of which potentially viable companies that are in financial distress can be "rehabilitated". Many of the entities facing financial difficulties are SOCs and questions have been raised as to why they are not being placed in business rescue. The Institute for Accountability in Southern Africa (Accountability Now) has written to the SABC chairman asking why the SOC board has not taken steps to initiate business rescue. The Auditor General has himself questioned why the SAA board did not report reasons for not adopting resolution to initiate business rescue while the company was in financial distress.<sup>60</sup> Section 129 of the Companies Act requires boards of companies in financial distress to consider business rescue and if not going that route, to notify creditors that the board will not be initiating business rescue, giving reasons for their decision. Not sending out such a notice and carrying on with business while in financial distress may result in a contravention of section 22, which prohibits a company from carrying on its business "recklessly, with gross negligence with the intention to defraud any person or for any fraudulent purpose". A contravention of section 22 could result in the SOC receiving a notice from the Companies Commission to cease its business activities. Personal liability for directors is also a possibility in terms of section 218 of the Companies Act. It has been suggested that business rescue may be the first step to financial rehabilitation for SOCs – as part of the bigger "complete overhaul of SOEs" as promised by President Ramaphosa in his State of the Nation address.

A further development in relation to addressing the financial woes of SOEs, is the pending Draft Public Audit Amendment Bill 2018. As discussed above, a number of SOEs received qualified audit reports from the Auditor-General, and quite a few did not submit their financial statements as per the requirements of the PFMA. This has become an annual occurrence, with the AG hauling the errant SOEs over the coals for qualified audits and irregular expenditure, but without any real "teeth" to his reports, as his office lacked the power to initiate investigations and recoup money.

<sup>59</sup> Joffe, H. "Eskom seems bright, but will it do right?" Business Live 31 January 2018 <https://www.businesslive.co.za/bd/opinion/columnists/2018-01-31-hilary-joffe-eskom-seems-bright-but-will-it-do-right/>

<sup>60</sup> Ensor, L. 'Auditor-general Kimi Makwetu: SAA had a net loss of R5.6bn' Business Live 8 March 2018 <https://www.businesslive.co.za/bd/national/2018-03-08-auditor-general-kimi-makwetu-says-saa-and-mango-given-qualified-opinions/> [Accessed 10 March 2018].

The Public Audit Amendment Act 5 of 2018 seeks to remedy this situation by providing the AG with the power to refer undesirable audit outcomes to appropriate bodies for investigation. It furthermore intends to provide the AG with mechanisms to issue debt certificates for appropriate authorities to recover money from these errant SOEs.<sup>61</sup>

# 06

## FINAL REMARKS

It is hoped that the promises from the President and the appointment of Minister Pravin Gordhan to the Department of Public Enterprises will result in the elusive Government Shareholder Management Bill finally seeing the light, and that it in fact will live up to the recommendations of the PRC and the needs expressed above, and in particular that it will move away from the board appointment processes favoured by the PFMA. The PFMA approach of vesting appointment and dismissal powers of board members and executives in the executive authority (relevant minister) has proven to take control of the affairs of the SOE out of the hands of the board. Such appointments and dismissals by the relevant ministers have also typically taken place without any oversight or transparency. It is hoped that the Government Shareholder Management Bill will instead move towards transparent processes that will ensure the ability of the SOE board to run the affairs of the entity without undue ministerial interference.

There is certainly evidence of Minister Gordhan taking the “cleaning up” process of SOEs seriously. In the past weeks, a number of troublesome SOE boards have been restructured and new appointments have been made and announced in public.<sup>62</sup> He has also promised to hold SOEs on a much shorter leash, including possibly requiring them to report to Parliament on a fortnightly basis.<sup>63</sup>

While these changes and promises are good news, these are still executive actions, and there still has not been much evidence of robust transparent and public processes relating to these new board appointments. Executive action may be defensible to solve current crises, but in the long term, more legislative clarity, accountability and oversight is required.

<sup>61</sup> Phillip, X. “Beware the auditor-general’s new teeth” *Business Live* 2 May 2018 <https://www.businesslive.co.za/bd/opinion/columnists/2018-05-02-xolisa-philip-beware-the-auditor-generals-new-teeth/> [Accessed 2 May 2018].

<sup>62</sup> “Pravin’s Picks: Meet the new board members tasked with resuscitating Denel” *Biznews* 10 April 2018 <https://www.biznews.com/sa-investing/2018/04/10/new-board-members-denel/> [Accessed 25 April 2018].

<sup>63</sup> “Gordhan gets tough on ‘largely captured’ State entities” *Polity* 2 May 2018 <http://www.polity.org.za/article/gordhan-gets-tough-on-largely-captured-state-entities-2018-05-02> [Accessed 3 May 2018].

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