

Concluding financial transactions with South African public entities: the legal considerations

by Clinton van Loggerenberg, Deborah Carmichael and Ntando Siswana

▲
[click to print
this article](#)

Following South Africa's sovereign credit rating downgrade by ratings agencies Standard & Poor's, Fitch and, on 9 June 2017, Moody's, as well as developments in political circles around allegations of "state capture", relations between private business and the country's public entities have become a hot topic.

An important aspect of the interaction between private business and public entities is the financing that private lenders (such as banks, private equity firms and hedge funds) advance to public entities, such as state-owned companies.

Lenders, bondholders and hedge counterparties expect that, from a legal perspective at least, the financial transactions that they conclude with public entities create legal, binding and enforceable obligations on the state and/or the relevant public institution with which they are contracting.

Below are some of the main legal considerations to bear in mind when transacting with South African public entities.

Section 66 of the PFMA

The Public Finance Management Act, 1999 (the "PFMA") is the principal legislation governing public finance in South Africa. It was enacted to promote, among other things, the efficient and effective management of public finances.

Section 66(1) of the PFMA prohibits an institution, to which the PFMA applies, from borrowing money, or issuing a guarantee, indemnity or security, or entering into any transaction that binds or may bind that institution to any future financial commitment, unless such borrowing or other transaction is authorised in terms of the PFMA and, in the case of public entities, is also authorised by other legislation that is not in conflict with the PFMA.

Consequences of non-compliance

There are serious consequences when an institution to which the PFMA applies fails to comply with section 66 of the PFMA. Section 68 of the PFMA provides that, if a person lends money to an institution to which the PFMA applies or purports to issue, on behalf of such an institution, a guarantee, indemnity or security, or enters into any other transaction which purports to bind such an institution to any future financial commitment, without complying with section 66 of the PFMA, the state and/or that institution will not be bound by the lending contract or the guarantee, indemnity, security or other transaction.

The consequences of purporting to conclude a transaction that has not been approved under the PFMA are even more dire for an official of a public entity. Section 86(3) of the PFMA imposes a criminal penalty on a person who purports to act on behalf of a public entity or who enters into a contract that purports to bind a public entity to a future financial commitment. If found guilty, such a person may be liable on conviction to a fine or imprisonment for up to five years.

"Public entity"?

The PFMA applies to, among others, government departments, constitutional institutions and public entities listed in schedule 2 and 3 of the PFMA.

The PFMA defines a public entity as a national or provincial public entity. This definition extends to national and provincial government business enterprises, boards, commissions, companies, corporations, funds and any other entities that:

1. have been established in terms of national or provincial legislation;
2. are fully or substantially funded either from the National Revenue Fund or by way of a tax, levy or other money imposed in terms of national legislation; and
3. are accountable to Parliament.

In establishing whether a counterparty is a public entity to which the PFMA applies, the first place to look would be the schedules to the PFMA. If not specifically listed in the PFMA, a further analysis would be required to determine whether that entity meets the other requirements to be considered a public entity.

The Minister of Finance has powers to exempt any institution to which the PFMA applies, or any category of those institutions, from any specific provisions of the PFMA.

Does the transaction involve a "future financial commitment"?

Determining whether or not a transaction falls into the category of a future financial commitment is not always straightforward. The prevailing case law dealing with the meaning of the term future financial commitment is not particularly clear. This means that a case-by-case analysis is required for each transaction, and specific legal advice should always be sought in this regard.

Is the transaction properly authorised?

Section 66(3) of the PFMA prescribes the persons through whom public entities may borrow money or issue a guarantee, indemnity or security, or enter into any other transaction that binds or may bind that public entity to any future financial commitment.

A public entity listed in schedule 2 of the PFMA may only enter into such transaction through its accounting authority, namely, its board of directors.

When dealing with a schedule 2 public entity, it is important to ensure that:

1. the transaction has been properly authorised by the accounting authority; and
2. the resolutions in terms of which the transaction have been authorised comply with the requirements of section 66 of the PFMA.

Delegation of authority

The boards of some public entities purport to delegate the authority to approve loans or other transactions for a future financial commitment to a specific person or persons occupying certain posts in that institution. According to section 66(6) of the PFMA, such a delegation can only be given with the prior written approval of the Minister of Finance. It is not sufficient to simply notify the Minister of Finance – prior approval, in writing, must be obtained.

Where a transaction appears to be approved by anyone other than the accounting authority for that institution, it is imperative to ensure that there is a valid delegation of the accounting authority's authority in place, and that such delegation of authority enjoys valid ministerial approval.

Submission of the borrowing programme

Section 66(7) of the PFMA prescribes that an entity authorised to borrow money must annually submit to the Minister of Finance a borrowing programme for the year. Furthermore, such entity may not borrow money in a foreign currency above a prescribed limit, except when that public entity is a company in which the state is not the only shareholder.

Lenders to public entities need to satisfy themselves that the public entities to which they are lending money have, in fact, submitted their borrowing programmes to the Minister of Finance for that year. Further, where the borrowing is denominated in foreign currency, such borrowing must be within the prescribed foreign currency borrowing limits.

Other legislation

In addition to the PFMA, public entities will often also be governed by specific legislation in terms of which they have been established. This legislation must be considered together with the provisions of the PFMA.

It is important to note that in the event of any inconsistency between the PFMA and any other legislation, the provisions of the PFMA prevail.

Conclusion

A public entity borrower's/counterparty's non-compliance with section 66 of the PFMA has very serious implications. For the party transacting with the public entity, there is the risk that the transaction will be void and therefore unenforceable. For officials or employees acting on behalf of a public entity, there is the risk of criminal conviction, which comes with the prospect of prison time.

It is very important for parties to involve legal counsel right at the beginning of any transaction involving a public entity where a loan, a guarantee, indemnity, security or any other future financial commitment may be involved.

For more information, or assistance in this regard, please contact:



Clinton van Loggerenberg

banking and finance | director

cell: +27 82 526 2888



Deborah Carmichael

banking and finance | director

cell: +27 82 787 9495



Ntando Siswana

banking and finance | associate

cell: +27 82 560 3677



No information provided herein may in any way be construed as legal advice from ENSafrica and/or any of its personnel. Professional advice must be sought from ENSafrica before any action is taken based on the information provided herein, and consent must be obtained from ENSafrica before the information provided herein is reproduced in any way. ENSafrica disclaims any responsibility for positions taken without due consultation and/or information reproduced without due consent, and no person shall have any claim of any nature whatsoever arising out of, or in connection with, the information provided herein against ENSafrica and/or any of its personnel. Any values, such as currency (and their indicators), and/or dates provided herein are indicative and for information purposes only, and ENSafrica does not warrant the correctness, completeness or accuracy of the information provided herein in any way.

info@ENSafrica.com
level 2 BBBEE rating (South Africa)

