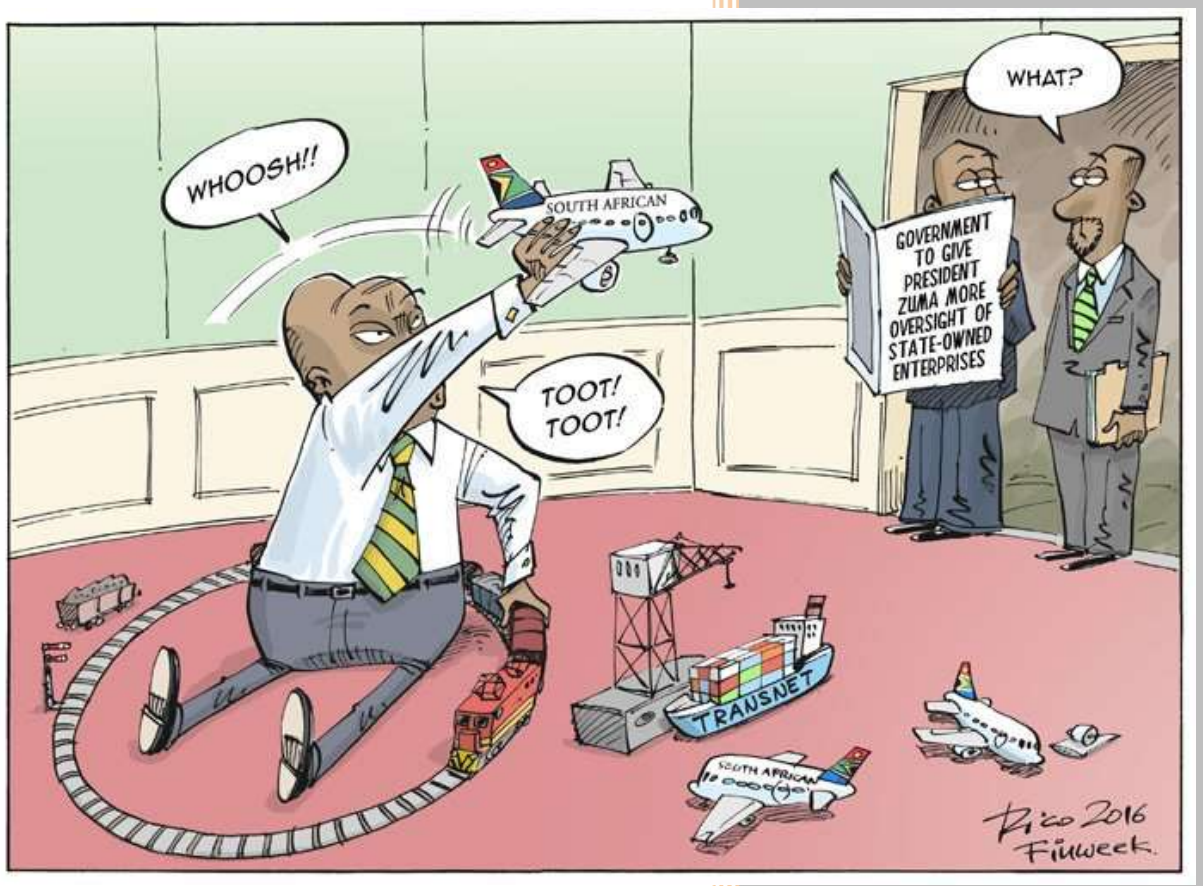
2019

SUBMISSION BY THE DULLAH OMAR INSTITUTE TO THE ZONDO COMMISSION



Contents

Submission by the Dullah Omar Institute to the Zondo Commission on the appointment of board directors to state-owned enterprises

SOEs play an important role in South Africa: they need to be supported by the state but also called to account. Government should work towards a consistent strategy for SOEs, which includes firm commitments to support strategic SOEs where the economic climate is affecting their sustainability (PLAN). SOEs should strengthen their financial and performance management systems to account in a credible manner on their finances and performance (DO). The oversight by the departments, ministers and parliamentary committees responsible for the SOEs should include strong in-year monitoring and ensuring that governance policies and practices are in place (CHECK). Boards and chief executive officers should be held accountable for the delivery and financial results of the SOEs, and there must be immediate and effective consequences for poor performance and transgressions (ACT).[1]

Background

1. The Dullah Omar Institute (DOI) is a research institute in the Faculty of Law at the University of the Western Cape (UWC) and is currently undertaking research on the appointment of State-Owned Enterprises (SOE) Board Directors. SOEs are enterprises where the state has significant control through full, majority, or significant minority ownership. In this definition are included SOEs which are owned by the national government, as well as SOEs owned by provincial and local governments.[2] The constitutional framework directly applicable to SOE includes Chapter 3 (Cooperative Government) and Chapter 10 (Public Administration). The Public Finance Management Act and the Companies Act further set out the regulatory framework for SOEs as does the various founding laws of specific SOEs.

[1] AGSA (2017*) General Report on the National and Provincial Audit outcomes for 2016/17*, p. 51.
[2] https://www.pwc.com/gx/en/psrc/publications/assets/pwc-state-owned-enterprise-psrc.pdf

2. As at the end of May 2012, there were 715 SOEs across all three spheres of government.[3] The focus of DOI's research is on national SOEs, thus excluding provincial and municipal public enterprises. There are some 120 national SOEs in South Africa engaging in a wide range of enterprises such as transport, electricity provisioning and supporting people with disabilities. Many of them carry out a service delivery mandate and/or a mandate that impacts on a constitutional right. Too many of these SOEs are performing far below expectations and/or are rife with corruption and maladministration. SOE Boards represent both a critical layer of accountability and oversight for the SOE administration and the all-important link between the state and the SOE. SOE failures must therefore be attributed to failed leadership at the board level. There is a widespread and persistent narrative, supported by a wealth of media reports and confirmed by organs of state, that many SOE board members have been 'captured' to represent outside interests, whist serving on these boards. This brings the criteria and procedure for, the appointment of board members into sharp focus.
3. The research focuses on two key flaws in the appointment and dismissal of SOE board members. The first flaw 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, ostensibly in consultation with cabinet. This has proven to be problematic and does not represent the 'robust and transparent' process, recommended by King IV.[4]
    - The appointment procedures are a function of the problematic triplicate stakeholder role of government, being shareholder, industry policy maker and regulator combined into one.
    - The link between the public and governance of SOEs is absent, or ill-defined at best. Parliament plays a direct role in appropriating funds to government departments and overseeing their performance and expenditure. However, SOEs often raise their own revenue, thereby avoiding a key component of Parliament's oversight power. However, they return to Parliament to approve emergency bail-outs. This disjuncture finds expression in the appointment procedures.
    - Partly because of the conflicting legislative framework (see below), procedures for the appointment of SOE board members often lack integrity and are not transparent, 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.

[3] Presidency (2013) *Presidential Review Committee Report on State-owned Entities*, Vol 1, p. 8
[4] IODSA (2016) *King IV – Report on corporate governance for South Africa*, p. 116.

4. 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.
5. The purpose of this submission is threefold:
    - To provide the Commission with information on the confusing and problematic legal frameworks regulating SOEs and more specifically the appointment of Board Directors
    - To provide contextual information to assist in the description and analysis of state capture
    - To support the Commission in the development of recommendations, especially where it concerns the appointment of SOE Board Directors.
6. The submission does not deal with specific factual matters concerning state capture, but rather with systemic issues and problems in law and design that have enabled corruption with specific reference to SOEs. The submission consequently deals with five thematic issues being:
    - Declining public trust in the state as a consequence of corruption.
    - The financial constitution and corruption
    - The confusing legal framework governing SOEs with particular reference to the appointment of directors to boards of SOEs
    - Good practice from elsewhere
    - Recommendations.
7. The submission includes three research papers in full attached as Appendices 1, 2 and 3:
    - Steytler, N. (2017) *The 'financial constitution' and the prevention and combatting of corruption: a comparative study of Nigeria, South Africa and Kenya*, Paper delivered at the 5th SASCA Conference, 'Corruption and constitutionalism in Africa: Revisiting control measures and strategies', STIAS, September 2017.
    - Wandrag, R. (2018) *The legal framework for the appointment and dismissal of SOE board members*, Dullah Omar Institute, University of the Western Cape.
    - Wandrag, R. (2018) *The legal framework governing the appointment and dismissal of board members and executives of ESKOM, PRASA and the SABC*, Dullah Omar Institute, University of the Western Cape.

Decline in public trust

8. State capture did not only come at a financial cost as particularly SOEs were looted. There was a wider impact and increasingly as state institutions (including SOEs) failed to deliver on their mandates, it was an intensifying consequence that the public increasingly lost trust in the state. This section unpacks the notion of public trust and the consequences state capture had for the legitimacy of state institutions.

9. Trust can be described as 'the belief, despite uncertainty, that something you believe should be done will be done and the belief, despite uncertainty, that something you believe should not be done, will not be done, the outcome of which will be beneficial to you or another'.[5] Taking a broader perspective, trust in an institution is at least partly reliant on the behavioural conduct of that institution.[6] Trust in the police, for example, therefore, is to some degree a function of perceptions of police conduct.[7]
10. Trust is not simply a state of mind of an individual, but rather involves a consequence associated with some kind of risk to one's ultimate welfare. The Mirriam-Webster Dictionary defines trust as "assured reliance on the character, ability, strength, or truth of someone or something" with synonyms being confidence, credence, faith, and stock. In addition, trust and confidence both imply a feeling of security. Trust also implies instinctive unquestioning belief in and reliance upon someone or something like a group to which one belongs or a public institution established to protect citizens.[8] Levi and Stoker define trust as relational in nature, and argue that 'it involves an individual making herself vulnerable to another individual, group, or institution that has the capacity to do her harm or to betray her.'[9]
11. Table 1 shows the levels of public trust in public institutions as found by Afrobarometer in 2015. The fact that more than half of South Africans said they had no or very little trust in a number of key institutions (e.g. Parliament) and must be seen at least in part as a consequence of state capture. The failure of Parliament to hold the executive accountable is reflected in the fact that 58% of South African had little or no trust in Parliament.

Table 1 Trust in public institions – South Africa 2015[10]

Institution	Somewhat/A lot	Not at all/Just a little	Don't know
President	1	66	34
Local government council	2	62	36
Opposition political party	1	58	43
Parliament	1	58	41
Ruling party	1	56	43
Police	1	54	45

[5] Boda, Z. & Medve-Bálint, G. (2017) How perceptions and personal contact matter: The individual-level determinants of trust in police in Hungary, *Policing and Society*, Vol. 2 No. 7, 732-749.
[6] Boda, Z. & Medve-Bálint, G. (2017)
[7] Boda, Z. & Medve-Bálint, G. (2017).
[8] Liqun Cao, (2015) "Differentiating confidence in the police, trust in the police, and satisfaction with the police", *Policing: An International Journal of Police Strategies & Management*, Vol. 38 Issue: 2, pp.239-249.
[9] Levi, M., & Stoker, L. (2000) Political trust and trustworthiness. *Annual review of political science*, Vol.3 No.1, 475-507.
[10] Chingwete, A. (2016) In South Africa, citizens' trust in president, political institutions drops sharply, *Afrobarometer*, Dispatch No. 90, p. 3.

Institution	Somewhat/A lot	Not at all/Just a little	Don't know
Provincial premier	6	47	47
Courts of law	2	41	56
Traditional leaders	19	38	44
Independent Electoral Commission	4	38	58
Office of the Public Protector	10	32	58
Religious leaders	5	32	63
National Prosecuting Authority	14	31	55
Tax department (SARS)	7	31	62
Directorate of Priority Crimes	13	30	57
Army	4	26	70
Government broadcasting service	2	23	75
Independent broadcasting service	3	18	79

12. A successful democratic state depends on whether or not the state is perceived to be legitimate. This requires that the public trusts the institutions of state to behave in the broad public interest. Even when difficult to define, 'public interest serves as the fundamental criterion for establishing the legitimation of power. Political power, then, is legitimate and necessary, and even acceptable, only inasmuch as it can be established that it serves public interest.'[11] This legitimising function is dependent on trust, namely the trust that the public has that political power will be used in the public interest; conversely if the institutions of state are not trusted by the public to act in its interest, it creates a legitimacy deficit for these institutions.
13. State capture and the repurposing of state institutions (e.g. Parliament with regard to the Public Protector's report on Nkandla) saw a drastic decline in public trust in these institutions and thus a growing legitimacy deficit for them. A legitimacy deficit on such as a scale (e.g. 58% of people have no or little trust in Parliament) places the entire democratic order at risk since the very institutions created to protect the democratic order are flouting their constitutional obligations. The cost of state capture should then also be measured in these non-financial terms with reference to the harm it caused to the reputation of state institutions.

[11] Méthot, JF. "How to define public interest"*? Collège dominicain de philosophie et de théologie Ottawa ON Canada*, Lecture given at the EPAC Round-Table held at Saint Paul University, 29 January 2003, https://ustpaul.ca/upload-files/EthicsCenter/activities-How_to_Define_Public_Interest.pdf (Accessed: 10 March 2019).

The financial constitution and SOEs

14. There is not a document called "the financial constitution" but there are provisions in law that specify how the state should manage its finances. The following provides a summary of key points covered in the paper attached as Appendix 1.
15. In Anglophone Africa the constitutional regulation of public money exhibits the following features:
    - A democratically elected parliament authorises the raising of revenue;
    - A semi-autonomous revenue collection authority deposits all revenue in a single revenue fund (bar a few explicit exceptions);
    - A democratically elected parliament authorises withdrawals from the single revenue fund by means of an Appropriations Act, subject to some limitations;
    - Independent bodies determine or advise on aspects of expenditure;
    - An independent body ensures that expenditure decisions comply with the Appropriations Act (e.g. Kenyan Controller of Budget);
    - An independent body (Public Service Commissions) controls the largest expenditure item – personnel appointments – ensuring value for money and preventing nepotism;
    - An independent office of the Auditor-General reviews *ex post facto* the financial statements and transactions of state entities;
    - A legislature oversees the legality and appropriateness of the spending of the appropriated funds;
    - A national treasury is established; and
    - An independent central bank maintains the value of the currency.
16. These features express the basic principles of constitutionalism. First, the raising and expenditure of funds are subject to democratic decision-making; secondly, the expenditure of funds is subject to limitations, including the separation of powers; thirdly, the raising and expenditure of funds are subject to the rule of law; and finally, the expenditure of funds should be for a public (developmental) purpose.
17. Events around SOEs in recent years saw several deeply worrying developments. These need to be seen against the background of the financial constitution, since it is to some extent weaknesses in this regard that created fertile ground for corruption.

An Act of Parliament necessary to raise revenue

18. Parliamentary control over the raising of money is slowly dissipating through the corporatisation of the state. SOEs, operating at arm's length from the executive and beyond the reach of Parliament, are borrowing with little restraint. Some SOEs (including Eskom and PRASA), are highly indebted, but syphon off large amounts to beneficiaries. Consequently, they require both government guarantees for such loans, and bail outs when the loans can no longer be serviced. Parliament thus only comes in the picture when the bailout money must be approved.

Controls over the collection of revenue

19. Since the 1990s the establishment of semi-autonomous revenue authorities (SARAs) in Africa, particularly Anglophone Africa, has been popular; SARAs are supposed to enhance tax collection, reduce tax evasion and corruption, and provide better service to tax-payers, as the aim was to depoliticise the tax administration.

20. South Africa can be no better example of how the semi-autonomous SARS, under dodgy leadership, was captured in the corruption network. From a world class institution under the leadership of Pravin Gordan, it was hollowed out under the leadership of Tom Moyane. Allegations abound about a comfortable relationship between Moyane, Zuma and the Gupta family, and more specifically that tax returned from Gupta family members rarely exceeded R1 million per year and was accepted as such by SARS under Moyane. Yet the family was raking in billions through government contracts. The result is that a well-connected family not only benefitted enormously from state contracts, they also avoided their tax responsibility which those billions would impose. Questions must also then be asked about the boards of these SOEs who apparently approved contracts given to Gupta companies, or where the Gupta family acted as third party (e.g. case of SAP and ESKOM).

Depositing all revenue collected in a consolidated revenue fund

21. The basic rule that all revenue collected by the executive should be placed in a single consolidated revenue fund under the trusteeship of the legislature is often avoided if not ignored. The rule is avoided when part of the executive is corporatised to operate on business principles, including turning a profit. The result is that the income of SOEs does not form part of the consolidated revenue fund. In South Africa, only a portion of state revenue goes into the consolidated revenue fund; the portion raised by SOEs is deposited in separate bank accounts. As a result, Parliament has little oversight over the flow of money out of them. It is then for the SOE boards and management to determine how such funds will be used.

Act of Parliament necessary for withdrawals from consolidated revenue fund

22. A parliament's control over expenditure through the budget is, in the first place, limited to that which is in the consolidated fund. Off-budget funds readily escape parliamentary control. In South Africa, as a large slice of public funds is managed by SOEs their budgets are not part of the consolidated fund, Parliament has no authority over their use. The exclusion of SOEs from the fiscal constitution has led to high levels of corruption. The main thrust of the capture of the state was the control of key SOEs: the electricity utility ESKOM, the arms manufacturing company DENEL, and the railways company PRASA and Transnet.

Controller of Budget

23. In the absence of a constitutionally recognised office of the Controller of the Budget, its function is performed by the Accountant-General located in the National Treasury.[12] The autonomous functioning of that office thus depends much on the autonomous functioning of the National Treasury when it comes to matters of enforcing compliance with budget implementation. In South Africa the Auditor-General has annually reported on the high percentages of unauthorised spending at all three levels of government. Departments receive their voted budgets with strict rules requiring expenditure within the line items. Yet, there seems to be hardly any consequences when these rules are not complied with as the departments, in full control of the budgets, do as they please. Likewise, the billions of Rands of irregular expenditure (not following due procedure, usually with regard to procurement) also escapes the controlling hand of the Accountant-General. National Treasury also oversees major contracts entered into by SOEs requiring the signature of the Minister of Finance. The capturing of the National Treasury thus became an important target for those implicated in state capture.

24. The sacking in November 2015 of the Minister of Finance, Nhlanhla Nene (appointed in May 2014) for allegedly refusing to sign off on a multi-billion rand dodgy transaction of South African Airways and replaced by Des van Rooyen, saw the markets crash. The former Minister of Finance, Pravin Gordhan, was appointed to calm the markets but this was followed by a campaign against him. The capture of the Treasury can be considered to be complete when then President Zuma appointed Malusi Gigaba as Minister of Finance, the very same person who as Minister of Public Enterprises who allegedly facilitated the capture of the SOEs, and as Minister

[12] The responsibility of the Office of the Accountant General is to promote and enforce transparency and effective management in respect of revenue expenditure, assets and liabilities of institutions in all three spheres of Government. This includes the administration of the National Revenue Fund (NRF) and the Reconstruction and Development Programme Fund (RDPF), as well as Banking Services for national departments. The OAG is also responsible for developing policies and frameworks on Accounting, Internal Audit and Risk Management.

of Home Affairs reportedly expedited the granting of South African citizenship to the Gupta family.[13]

An independent office of the Auditor-General

25. The Auditor-General has often expressed his frustration that because government does not implement his recommendations, the public perception is that there are no real consequences for poor audit results. Passed in 2018, the Public Audit Amendment Act enhances 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.[14] Due to its weak enforcement hand, no direct attack on this institution has come to light, although the embarrassing disclosures of corruption must certainly have attracted unwanted attention. Moreover, SOEs are audited by their own private auditors, although the Auditor-General do audit on a sample basis some SOEs annually.

Parliament's oversight role over executive

26. Government departments have established SOEs performing government functions, once removed from direct control of ministers, operating on supposedly commercial principles under a board of directors, with the government as the shareholder. But the greater independence has also weakened parliamentary control and oversight over them. In South Africa, for example, the generation of electricity and rail transport were corporatised, only to fall prey to those implicated in state capture, and far from the scrutiny of Parliament.
27. Secondly, although armed with whatever information provided by reports from the Auditor-General and other independent bodies, Parliament has fulfilled its oversight role poorly and the oversight role is mainly fulfilled by the opposition parties in Parliament.

An independent central bank

28. Proclaiming the central bank's independence in a constitution may be a necessary, but is certainly not a sufficient condition for such independent decision-making; there is often a deep schism between the law and practice. The South African Reserve Bank (SARB) was not a problem to those implicated in state capture. The latter had no problem with the Bank's policy of price stability, but the Bank has strong investigative powers about money flows and the

[13] "Gigaba was 'incorrect', citizenship for Guptas should be revoked: parliament" *TimesLive*, 18 March 2019, https://www.timeslive.co.za/politics/2019-03-18-gigaba-was-incorrect-citizenship-for-guptas-should-be-revoked-parliament/

[14] S 5 Public Audit Amendment Act 5 of 2018.

ability to seize assets; it has the capacity to expose (and has done so) the money laundering activities of the Guptas. In responding to a complaint about the life boat the Reserve Bank threw to ABSA Bank during the apartheid era and had not repaid, the Public Protector, Busisiwe Mkhwebane, took the opportunity and made a blistering attack on the independence of the SARB. Not at all related to the complaint, the Public Protector instructed Parliament to amend the Constitution by removing, first, the object of protecting the value of the currency, and secondly, the independence of the institution. When the Reserve Bank took the findings on review, Judge John Murphy set these instructions aside because they were 'unlawful', and 'procedurally unfair'.[15]

Conclusion

29. Public money is not used in service of the public but is looted for the pockets of the political and business elite that have captured the very institutions of state, including the independent ones. South Africa showcases the sad reality of how its 'financial constitution' has been hollowed out when predatory political and business interests set their mind on capturing the state for private gain. Corruption is not a foregone conclusion in the corporatisation of state entities, provided Boards step in and fill the gaps left by such entities sitting outside, or avoiding some key elements, of the financial constitution. The current situation has, however, shown that SOE boards did not step in to fill the gap.

A confusing legislative framework for the appointment of SOE directors

30. The following is based on the two papers by Wandrag attached as Appendices 2 and 3.
31. 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.
32. In South Africa, unfortunately many SOEs have proven to be a burden on government funds by repeatedly requesting and receiving financial bail-outs. In 2017 the Auditor-General reported that guarantees against the National Revenue Fund had been issued to 12 SOEs to the value R440 billion and to Eskom alone a guarantee of R350 billion.[16] The poor governance and

[15] *ABSA Bank Limited and Others v Public Protector and Others* (48123/2017; 52883/2017; 46255/2017) [2018] ZAGPPHC 2; [2018] 2 All SA 1 (GP) (16 February 2018) paras 123 and 103.
[16] AGSA (2017*) General Report on the National and Provincial Audit outcomes for 2016/17*, p. 50.

financial failures 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.

33. 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 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
34. To a large extent, these legal instruments govern different aspects of the SOEs' existence, but the one area in which they 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.
35. 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".[17] 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".[18]
36. 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.[19] This is in line with OECD-SADC (Organisation for Economic Cooperation and Development – Southern Africa Development Community) recommendations in this regard emphasising simplification, streamlining and harmonisation of legal forms.[20] The Department of Public Enterprises, as the department

[17] Public Protector (2016) *"State of Capture" - A Report of the Public Protecto*r, Report 6 of 2016/17, para 7.7, pp. 347-348.
[18] AGSA (2018*) General Report on the National and Provincial Audit outcomes for 2017/18*, p. 110.
[19] The Presidency, The PRC's 31 recommendations on SOEs, 28 May 2013, https://www.politicsweb.co.za/documents/the-prcs-31-recommendations-on-soes
[20] OECD-SADC (2014) *Guidelines on the governance of state-owned enterprises for Southern Africa,* https://www.oecd.org/daf/ca/SOE-Guidelines-Southern-Africa.pdf pp. 6 – 7.

responsible for six 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 in 2013. The same undertaking has been given for 2018.

37. The PRC recommendations also include the standardisation of board and executive appointments and dismissals, following transparent and merit-based recruitment processes.[21]
38. These appointments (board members and executives) should not simply be the prerogative of the 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 and recruitment process. Selections should be done on merit and suitability for and knowledge of the specific sector.
39. In addition to the strengthening and clarification of the rules regarding board and executive appointments and dismissals, financial oversight over SOEs must be strengthened. The enhanced powers of the Auditor-General under the Public Audit Amendment Act (see above) is a step in the right direction.

Who appoints SOE Board Directors?

40. The question as to who appoints board members of SOEs is regulated in a complex web of overlapping and, at times contradictory laws. In her paper, comprehensively outlining the legal framework for the appointment and dismissal of board members, Wandrag sets out these complexities. With respect to most SOEs, there are three different legal frameworks that must be considered, namely (1) the Public Finance Management Act 1 of 1999, (2) the Companies Act 71 of 1998 and (3) a specific law establishing the SOE, referred to here as the 'founding legislation'.
41. In addition to these laws, there are various 'soft law' instruments, i.e. protocols and guidelines that are (usually) not binding but are (supposed to be) influential. Examples are the King III and King IV principles, the Protocol on Corporate Governance in the Public Sector and the Handbook for the Appointment of Persons to Boards of State and State-Controlled Institutions.
42. In dealing with the question as to who has the authority to appoint board members, the three frameworks present a convoluted picture. The key tenets are as follows:
    - In principle, the Public Finance Management Act (PFMA) is always applicable to an SOE. However, the PFMA does not regulate the appointment of board members. The PFMA includes the power to appoint board members within its definition of "ownership control". In SOEs, "ownership control" is exercised by the national government, through the relevant

[21] The Presidency, The PRC's 31 recommendations on SOEs, 28 May 2013, https://www.politicsweb.co.za/documents/the-prcs-31-recommendations-on-soes

Minister. The PFMA therefore implicitly locates the power to appoint board members in the relevant Minister. However, it does not provide any procedures for the appointment or dismissals.

- The Companies Act applies to all SOEs that are registered as companies. Not all SOEs are registered as such (PRASA, for example, is not). When an SOE is registered as a company in terms of the Companies Act, the Act will apply and provide that its directors are elected at the company's Annual General Meeting (AGM). The company's Memorandum of Incorporation (MoI), the document that sets out the rights, duties and responsibilities of shareholders, directors and others within a company, may provide for another procedure, however.
- The founding law sometimes does, and sometimes does not regulate board appointments. For example, the Broadcasting Act (4 of 1999) deals with the appointment of non-executive SABC board members but the Eskom Conversion Act (13 of 2001) is silent on the appointment of board members to ESKOM.

43. In summary, the law is unclear and contradictory. What is clear, however, is that the law often leans towards vesting the power to appoint board members in the relevant Minister without any substantive or procedural requirements to guide the Minister's decision-making.

Who appoints executives?

44. In addition to the question as to who appoints board members, there is the question as to who appoints executive board members, such as the entity's Chief Executive Officer (CEO) and the Chief Financial Officer (CFO). This is a critical power and the law must be clear on *who* has the power to appoint executives and *how* this power is circumscribed. South Africa has been rudely awakened to this, given the recent history of very serious challenges with respect to the appointment of executives to prominent SOEs. The legal wrangling over the appointment of the CEO of the SABC, the debacle with the appointment and subsequent removal of the CEO of ESKOM and the myriads of CEOs and interim CEOs that have been appointed to PRASA, bear testimony to this. In all these cases, the damage inflicted upon users, commuters, the citizenry at large and the fiscus, has been immense.
45. Here too, the law presents a mixed picture:
    - The PFMA, being the Act that is always applicable, does not contain any details. However, the PFMA includes the power to appoint the executive head under the definition of "ownership control", which is exercised by the National Executive, through the relevant Minister. So, in terms of the PFMA, it is the Minister's responsibility.

- The Companies Act (applicable to most, but not all SOEs) puts forward a different approach. It considers the power to appoint the executives as part of the running of the business. So, in terms of the Companies Act, it is the Board (and not the Minister) who appoints the executive head. It would appear that this may not be changed by the company's Memorandum of Incorporation (MoI).
- The founding law sometimes does, but very often does not, regulate who appoints executives. For example, in regulating the SABC, the Broadcasting Act regulates the appointment of non-executive board members but not the appointment of executive board members. However, with respect to the SABC, the Court has determined that executives are appointed by the SABC Board and not by the Minister. Wandrag details the protracted legal wrangling over this issue, which took place at great cost to the taxpayer. The ESKOM Conversion Act does not regulate the appointment of executives, arguably leaving it entirely to the Minister.
- The applicable 'soft law' is contradictory. The SOE Protocol suggests that the decision be taken by the Board "in concurrence with the Minister". In other words, the Minister may veto the Board's decision. King IV suggests that the Board be involved "to the greatest extent possible". Whilst leaving it open, it seems to favour the least possible involvement by the Minister.

46. In summary, the law surrounding the appointment of board executives is also unclear and contradictory with clearly opposing approaches emanating from the PFMA and the Companies Act, or any measures to make it more transparent.

Who dismisses executives?

47. In what is now becoming a familiar refrain, the question as to who dismisses an SOE's executives (such as the CEO and the CFO) can also not be answered easily:
    - The PFMA again includes the power to remove an executive in its definition of "ownership control", which is exercised by the relevant Minister.
    - The Companies Act provides that it is the majority shareholder that may dismiss any director, including the CEO. In practice, this also means that government, through the Minister, dismisses executives. The Act does insist on prior notice and an opportunity for an embattled executive to state his or her case.
    - The founding law sometimes does, but very often does not, regulate who dismisses executives. For example, the Armaments Corporation of South Africa Limited Act (51 of 2003), the founding law for Armscor, provides that the Minister dismisses board members. Despite the specific rules in the founding legislation, the courts have insisted on procedural fairness, often borrowing from provisions in the Companies Act. The Broadcasting Act is an exception in that it provides that the National Assembly dismisses directors.

- King IV suggests that the Board should have the power to remove executives. It thus goes against the grain of the PFMA and the Companies Act, which lean towards the relevant Minister exercising that power.

48. The overall picture is that the various different legal frameworks lean towards the relevant Minister dismissing executives. In doing so, it creates a framework in terms of which SOE executives are beholden to the Minister as opposed to being accountable to the Board. This is at odds with corporate governance principles as espoused by King IV.

How are these conflicts resolved?

49. The fact that there are multiple laws applicable to the appointment of SOE Board members is not necessarily an insurmountable problem. In general, the law can be quite capable of offering clear rules for resolving conflicts between laws. These conflicts do not have to result in legal uncertainty as long as the 'supremacy' clauses, i.e. rules that determine which law prevails in case of conflict, are clear and consistently applied. In the case of the appointment and dismissal of board members to SOEs, however, the rules are neither clear nor consistently applied.
50. The PFMA and the Companies Act seem to be clear about which among the two of them prevails: if there is conflict between the PFMA and the Companies Act, the PFMA prevails. If there is conflict between the Companies Act and the founding legislation, the Companies Act prevails. However, Wandrag points out that the courts have at times found otherwise and held that the founding law prevails over the Companies Act. The courts seem to favour an approach whereby the specifics of the founding legislation prevail over the generally applicable provisions of the Companies Act. In sum, the rules and practice for resolving conflicts between the three applicable frameworks do little to settle the uncertainty with respect to the appointment.

Observations

51. A number of conclusions can be drawn, based on the above overview of the legal frameworks applicable to the appointment and dismissal of board members.

The legal framework is fragmented and favours the executive

52. The legal framework for the appointment of board members of SOEs is fraught with overlap and contradiction. At the very least, the legal uncertainty that has resulted from this has not worked in favour of good governance at SOEs. The protracted court battles with respect to appointments and dismissals at the SABC and other SOEs bear testimony to this.
53. The second observation is that the PFMA appears to be a significant part of the problem. While the PFMA is generally regarded as providing a rigorous framework for the responsible handling of public finances, its treatment of the appointment and dismissals of board members to SOEs is problematic. The PFMA is silent on who appoints board members and what the procedure is.

Implicitly, it thus becomes a power exercised by the Minister without any procedural rigour or transparency and subject to no specific criteria. Given that the PFMA trumps the Companies Act, this is particularly problematic. If the specific founding legislation contains provisions on the appointment of board members, these would apply. However, oftentimes, the founding legislation does not.

Company rules for boards are not suitable for state-owned companies

54. The Companies Act is ill-designed for the specific nature of a state-owned company. Targeted at companies, it assumes that shareholders will vote at an AGM to elect a board. Given that the state is majority or sole shareholder in all SOEs, it also therefore starts off by effectively locating the power to appoint board members with the relevant Minister. However, it follows from the Companies Act that the Board, not the Minister, appoints executives. The company's Memorandum of Incorporation (MoI) may then provide for more specific rules and procedures. However, these MoIs are subject to significant influence by the Minister. MoIs are also often hard to obtain and not accessible as they should be. This is underscored by the SABC judgment where even the Court seemed to have been confused about the status of the most recent MoI, as Wandrag points out. MoIs also often contradict legislation (such as is the case with SABC) yet do not have the same legitimacy as legislation. The changing of MOIs, at the behest of a single Minister, has been an important instrument to 'tweak' the system in order to facilitate State Capture. For example, the SABC MOI was amended by Minister Muthambi to undermine the proper and independent functioning of the board to strengthen the hand of the Minister to become involved in operational matters.[22]

Government wants to control the appointment of executives

55. Fourthly, there is considerable pressure for Ministers to play a direct role in the appointment and dismissal of executives. It appears that a scheme by which the Board would recruit and decide, subject to consultation with the Minister, would not satisfy the government's desire to be involved. The PRC recommended for the board to recruit candidates, make recommendations to the Minister who would then decide in concurrence with Cabinet.

[22] Para 4.3.12 Evidence by most former Board members who gave evidence suggested that the Minister was at the centre of the appointment and removal of Board members, and curtailed the functions and responsibilities of the Board through amendments of the MOI which in turn impacted on the roles and responsibilities as outlined in the DAF, and in so doing contravened the Broadcasting Act. (Parliament of South Africa (2017) *Interim report of the ad hoc committee on the SABC board Inquiry into the fitness of the SABC board*, https://www.parliament.gov.za/storage/app/media/misc/2017/SABC_Ad_Hoc_Committee_Interim_Report_27_Jan_2017_adopted_published.pdf?utm_source=rss&utm_medium=rss

The protocols and codes have not worked

56. A fifth observation is that the emergence of a raft of 'soft law' instruments, such as the 2003 Protocol on Corporate Governance in the Public Sector, King III and King IV and the Handbook for the Appointment of Persons to Boards of State and State-Controlled Institutions, has not assisted much to clarify the question as who appoints board members and how this is to be done. Furthermore, King III and King IV do not address the issue with sufficient precision and, according to the PRC, the Handbook is widely ignored. This points in the direction of the need for a legislative framework instead of intensifying efforts to apply soft law.

Good practice from elsewhere

57. King IV pays little attention to the appointment process of board directors. The Protocol on Corporate Governance in the Public Sector is equally light on how directors should be appointed.[23] Principle 7 of King IV notes that: "The governing Board should comprise the appropriate balance of knowledge, skills, experience, diversity and independence for it to discharge it governance role and responsibilities objectively and effectively".[24] Substantial research on corporate governance has, however, been undertaken by the Organisation for Economic Co-operation and Development (OECD) and the submission will consequently focus on findings from two OECD reports.[25]
58. The OECD has formulated 20 principles for corporate governance based on extensive research amongst its members. The below extract lists the principles relevant to the nomination and appointment of board members and these are discussed further below:[26]

> *II.* ***The rights and equitable treatment of shareholders and key ownership functions****. The corporate governance framework should protect and facilitate the exercise of shareholders' rights and ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.*

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[23] Dept of Public Enterprises (2002*) Protocol on Corporate Governance in the Public Sector*, Pretoria: Dept of Public Enterprises.
[24] King IV, p. 40.
[25] OECD (2015), *G20/OECD Principles of Corporate Governance*, OECD Publishing, Paris. http://dx.doi.org/10.1787/9789264236882-en OECD (2012), *Board Member Nomination and Election*, OECD Publishing. *http://dx.doi.org/10.1787/9789264179356-en* OECD-SADC (2014) *Guidelines on the governance of state-owned enterprises for Southern Africa,* https://www.oecd.org/daf/ca/SOE-Guidelines-Southern-Africa.pdf
[26] OECD (2015), *G20/OECD Principles of Corporate Governance*, OECD Publishing, Paris. http://dx.doi.org/10.1787/9789264236882-en OECD (2012), *Board Member Nomination and Election*, OECD Publishing. *http://dx.doi.org/10.1787/9789264179356-en*

Principle II: A: Basic shareholder rights should include the right to: 1) secure methods of ownership registration; 2) convey or transfer shares; 3) obtain relevant and material information on the corporation on a timely and regular basis; 4) participate and vote in general shareholder meetings; 5) elect and remove members of the board; and 6) share in the profits of the corporation.

Principle II.C.3: C. Shareholders should have the opportunity to participate effectively and vote in general shareholder meetings and should be informed of the rules, including voting procedures, that govern general shareholder meetings: 3. Shareholders should have the opportunity to ask questions to the board, including questions relating to the annual external audit, to place items on the agenda of general meetings, and to propose resolutions, subject to reasonable limitations.

V. Disclosure and transparency: *The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company*.

Principle V.A.4: Remuneration of the board and key executives

Principle V.A. 5: Information about board members, including their qualifications, the selection process, other company directorships and whether they are regarded as independent by the board.

VI: The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

Principle VI.D. The board should fulfil certain key functions:

5. Ensuring a formal and transparent board nomination and election process.

59. The OECD uses the term "shareholder" with reference to private corporations. In the case of South African SOEs, government is the main, if not the only, shareholder and the "public as stakeholders lack the power to exercise any influence over SOE governance. The typical corporate structure of shareholders having the unfettered power to appoint board members is therefore also not suited to the governance of SOEs."[27] King IV defines "shareholders" in terms

[27] Wandrag (2019) p. 5.

of the Companies Act[28] and provides a comprehensive description of "stakeholders" and "stakeholder inclusivity" as a governance value:

- Stakeholders
    - Those groups of individuals that can reasonably be expected to be significantly affected by an organisation's business activities, outputs or outcomes, or whose actions can reasonably be expected to significantly affect the ability of the organisation to create value over time.
    - Internal stakeholders are directly affiliated with the organisation and include its governing body, management, employees and shareholders.
    - External stakeholders could include trade unions, civil society organisations, government, customers and consumers.
    - Internal stakeholders are always material stakeholders, but external stakeholders may or may not be material.
- Stakeholder inclusivity
    - An approach in which the governing body takes into account the legitimate and reasonable needs, interests and expectations of all material stakeholder sin the execution of its duties in the best interests of the organisation over time. By following this approach, instead of prioritising the interests of the providers of financial capital, the governing body gives parity to all sources of value creation, including, among others, social and relationship capital as embodied by stakeholders. Consequently, this is an inclusive stakeholder-centric approach which stands in contrast with a shareholder-centric approach.[29]

60. The developments in SOEs in the last 25 years have clearly exposed the risk posed by too much discretion held by the executive as shareholder and the absence of public participation as stakeholders in SOEs in the appointment of Board Directors. The OECD-SADC Guidelines recommend that there "should be a clear separation between the state's ownership function and other state functions that may influence the operating conditions for SOEs, particularly with regards to legal enforcement and market regulation."[30] In addition, the OECD-SADC Guidelines are unequivocal about that it is the Board that appoints the CEO and the CFO.[31] As already noted, the current legal framework simply does not provide for the public as stakeholders affected by SOE operations to have their say in how well or not an SOE is performing or in appointments. A stakeholder-centric approach also appears to be absent from the current SOE landscape.

[28] S 57(1).
[29] King IV, p. 17.
[30] OECD-SADC (2014) p. 6.
[31] OECD-SADC (2014) p. 28 and 30.

61. OECD Principle II.A 4 and 5 states that shareholders have a right to "4) participate and vote in general shareholder meetings; 5) elect and remove members of the board". However, stakeholder inclusivity, defined above, requires a stakeholder-centric approach in contrast to a shareholder centric approach. There is no doubt that members of the public are at least indirect stakeholders to all SOEs and direct stakeholders in many, especially where the SOE mandate contains a constitutional obligation (e.g. Eskom).
62. The key issues raised by Principle II.C.3 reads "Shareholders should have the opportunity to ask questions to the board, including questions relating to the annual external audit, to place items on the agenda of general meetings, and to propose resolutions, subject to reasonable limitations." What is currently lacking from the legal framework and practice are opportunities for the public, as SOE stakeholders, to have a role in the appointment and dismissal of SOE directors. This could potentially happen when an SOE reports to Parliament through annual or ad hoc reporting and the scope of such reporting should also address appointments made or not.[32]
63. Principle V.A.4 and 5 deal with the disclosure of board member remuneration as well as disclosure of their qualifications, the selection process, other company directorships and whether they are regarded as independent by the board. At essence is transparency and the clear aim to ensure that board appointments are done on merit and need, and avoid conflicts of interest.
64. Principle VI.D.5 requires that the board should fulfil certain key functions, one of which is ensuring a formal and transparent board nomination and election process.
65. To this end the Board (a) needs to ensure that established procedures are transparent and respected; (b) the board has a key role in defining the general or individual profile of board members that the company may need at any given time, considering the appropriate knowledge, competencies and expertise to complement the existing skills of the board; (c) the board or nomination committee has the responsibility to identify potential candidates to meet desired profiles and propose them to shareholders, and/or consider those candidates advanced by shareholders with the right to make nominations.[33]
66. The OECD-SADC guidelines concur with the above and adds that the ownership function needs to be involved in designing a transparent nomination process that is clearly structured and based on verifiable skills and experience of the candidates.[34] It is further recommended that boards

[32] OECD-SADC (2014) pp. 25-26.
[33] OECD (2015), *G20/OECD Principles of Corporate Governance*, OECD Publishing, Paris. http://dx.doi.org/10.1787/9789264236882-en pp. 48-49.
[34] OECD-SADC (2014) p. 15.

must be composed in such a manner that they can function unconnected to senior levels of government. In this regard ministerial nominations must be vetted.[35]

Recommendations

67. From the above as well as the history of SOEs in recent years, three main issues can be lifted to guide recommendations:
    - There needs to be a diffusion of power and discretion when appointing SOE board members. There is currently too much power and discretion in the hands of the relevant minister and this has resulted in poor appointments as well as instability at board and senior management levels.[36] The government is also simultaneously the majority or sole shareholder, the policymaker and the regulator of SOEs. This is an untenable situation.
    - The public is an indirect shareholder in SOEs and a direct or indirect stakeholder in SOEs yet
        - relies on an opaque relationship between the executive and the SOE
        - there is no coherent framework for the appointment of SOE board directors
        - lacks the opportunity or forum to see that appointments to SOE boards are based on merit and the needs of the organisation and the public.
    - The current process of appointment is not transparent and appointments are generally made by the relevant minister in the absence of an obligation to consult wider. The lack of transparency can, at least in part, be attributed to the confusing legal framework and the fact that SOEs fall outside the financial constitution.
68. SOEs need to be brought **into the financial constitution** to ensure that there is accountability for public funds.
69. There needs to be **effective oversight** over SOEs and their boards to ensure that good governance principles and fiduciary duties are complied with. This duty rest simultaneously with the executive, AGSA and Parliament. In this regard it is particularly the powers of Parliament that need to be strengthened to hold boards accountable. The AGSA should audit samples of appointments on an annual basis. Such audits should be wide in scope and pay particular attention to possible kinship, political or other connections between board members and the executive.

[35] OECD-SADC (2014) p. 32.
[36] For example, in a recent report the AGSA reported that in a sample of 15 SOEs, 33% of CEO positions and 20% of CFO positions were vacant for six month or longer. AGSA 2017/18 p. 118.

70. There needs to be **one piece of overarching legislation** regulating the governance and procedures (e.g. regulating appointments and removal of boards or directors) of SOEs to ensure that there is consistency and that the powers and duties of SOE boards are set out in a transparent manner. This would not prevent an SOE or a sector that has more than one SOE from having legislation dealing with specific issues, save that such SOE legislation may not conflict with general SOE legislation.
71. As noted, the highly centralised power to appoint SOE board directors **needs to be dispersed**. This can be achieved in two main ways. The first is to use distinct and different structures to do vetting, handle nominations and recommend appointments to the executive. The second option is to diversify the structure handling the appointment process, which is essentially the principle underlying the Judicial Services Commission, which has representation from several sectors. A structure representing diverse interests groups limits the extent to which an individual or a particular interest group can dominate decision-making.
72. The **requirements for SOE board directors** need to be objective and clearly articulated in law. There needs to be a set of minimum requirements as well as exclusions from board membership. Supplementary criteria for filling a specific vacancy (e.g. member for finance or strategic considerations), as developed by the SOE board of directors, also need to be made public with an opportunity for input.
73. Prior to individuals applying for or being nominated for a position on an SOE board, they need to be **assessed for their general suitability** to serve on an SOE board. This will assess if the person is fit and proper as it relates to their professional and personal history, and specifically their conduct in the private and public sectors as well as their financial interests.
74. Persons who have occupied senior positions in SOEs in recent years (e.g. past five years), need to be **excluded** from service as a board director of an SOE.
75. The constitutional principle of **transparency** needs to be reflected at all stages of appointments and to this end there needs to be opportunity for meaningful stakeholder input.
76. SOE Boards need to be mandated to **appoint and remove the CEO and CFO**.
77. In order to serve an SOE in the best possible manner having regard to shareholder and stakeholder interests, it is recommended that a **board composition** represents four main sources of authority:
    a. Shareholders, such as the relevant minister
    b. Expertise from the sector, strategy, finances, human resources or other needs as identified
    c. Stakeholders, such as public, Parliament, employees, consumers etc
    d. Ex officio members such as the CEO and CFO

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