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FINANCE AND BANKING MATTERS

INSTANCES WHERE AN *EN COMMANDITE* PARTNER MAY LOSE ITS LIMITED LIABILITY PROTECTION

An *en commandite* partnership is created when parties agree to carry on the partnership in the name of one or some of the partners, while the partners whose names are not disclosed are known as *en commandite* partners (ECPs).

An ECP contributes a fixed sum of money to the partnership on condition that it receives an agreed share of the profits, but in the event of a loss it is only liable to its co-partners to the extent of the fixed amount of its agreed capital contribution to the partnership. ECPs are therefore not liable for the partnership debts to creditors of the partnership and it is this limited liability protection that is one of the main reasons why investment funds are frequently structured as *en commandite* partnerships.

Importantly though, to maintain their limited liability protection, ECPs may not actively participate in the business of the partnership. If they do, they may be regarded as an ordinary partner and so lose their limited liability protection.

Below are two ways in which an ECP in an investment fund may inadvertently lose its limited liability protection:

- By including its name in the name of the partnership: the purpose of keeping the ECPs confidential is to avoid persons dealing with the partnership to be under the mistaken impression that they are entitled to rely on the credit of the ECPs. The mere fact that third parties become aware that an investor in a fund is an ECP will not, however, have the effect that it loses its protection against creditors of the partnership for partnership debts. What is required is that the ECP must hold itself out to third parties as an ordinary partner and the third party must act on that assumption to its detriment. If the partnership name contains the name of one of the ECPs that would arguably have the effect that the ECP whose name appears represents, to the outside world, that it is an ordinary partner and it may then lose its limited liability protection.

- By participating in the investment decisions of the partnership by representation on an investment committee: it is common for investment funds to be structured in such a way that there is an investment committee which considers the making or disposal of an investment by the fund (the partnership).

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This structure may hold risk for ECPs in an *en commandite* partnership where those ECPs are entitled to appoint representatives to the investment committee (such a right to appoint representatives is understandable as ECPs may wish to have a say in how their capital contributions are used by the fund). The degree of involvement or 'participation in the partnership business' that is required before an ECP would be regarded as an ordinary partner is not clear. From case law it appears that more than 'interference with the business of the partnership' is required, but less than 'management or control'. If a partnership would only acquire or dispose of an investment if the investment committee recommends it, it may arguably amount to active participation in the partnership business by the ECP and it may then lose its limited liability protection.

It is also important to note that where one ECP loses its limited liability protection, it does not mean that the partnership is rendered an ordinary partnership with the other ECPs then rendered ordinary partners as well. Although it is common practice to talk about *en commandite* partnerships, it should be remembered that this is actually somewhat of a misnomer as it is not the partnership that is afforded the protection against third parties, but the ECPs. In other words, the *en commandite* protection relates to the partner and not to the partnership. So if one ECP does something that has the effect that it loses its limited liability protection, the limited liability protection of the other ECPs would not then be automatically affected by this.

Stephen Gie

CONSTRAINTS AND COMPLEXITIES OF FUNDING WATER PROJECTS FOR MUNICIPALITIES IN SOUTH AFRICA

South Africa is a water scarce country and subject to both droughts and periodic floods. Over the last few months there have been a number of news reports advising that various municipalities in South Africa have been without water. Increasing investments into water resource infrastructure is becoming increasingly important for the country. Coincidentally, on Tuesday, 19 March 2013, to mark the beginning of National Water Week in South Africa, the Water and Environmental Affairs Minister Edna Molewa officially unveiled the Komati Water Augmentation Scheme, a water resource project estimated to cost approximately R1.7 billion to complete.

One of the main difficulties that most infrastructure projects of this nature must overcome is securing financing, particularly from the private sector. This is a challenge for numerous reasons. In this article we will briefly consider one of the major constraints, namely the creditworthiness of the municipalities, which are integral in the provision of water services.

In South Africa, the National Water Act, No 36 of 1998 (Act) provides for all matters relating to water. The Act empowers the government, through the Minister of Water Affairs, to be the custodian of water and the only entity with the right to allocate and distribute water directly to the South African public (end consumer), through local municipalities. Importantly the Constitution recognises local government (municipalities) as an independent sphere of government with its own unique set of rules and level of importance. This means that municipalities have to raise their own funding (apart from the national budgetary allocation) and such funding will not be guaranteed by the national fiscus. Instead, when municipalities raise funding for infrastructure investments, they have to raise finance on their own books (or balance sheet) and bear the responsibility for repaying the debt. This presents certain constraints and complexities because municipalities have limited balance sheets and lack liquidity due to the current framework of local revenues, which is discouraging to private financiers.

Further, special purpose vehicles such as the Trans-Caledon Tunnel Authority (TCTA) established in terms of the Act, through which the government seeks funding for infrastructural investment of a project, also depend on the creditworthiness of municipalities when raising funding for the supply of water to urban areas. TCTA undertakes many projects with the cash flows from each project ring-fenced and only to be used to repay the lenders to that specific project. Accordingly, TCTA's ability to repay a loan for a specific project of an urban nature is directly dependent on the creditworthiness of the municipality benefitting from the project.

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Thus, when lenders decide to lend money to TCTA for an urban water project or a municipality for upgrading its own water infrastructure, they will examine the creditworthiness of the municipality.

Creditworthiness is important because when financing projects, lenders are most comfortable when lending money against known or identifiable commercial risks. This is because lenders are able to establish certain formulas for assessing the risk associated with loans to a project.

- A municipality is 'creditworthy' when its borrowing meets the risk standards of a lender. The following are some of the factors which may be considered when assessing creditworthiness and rating a municipality, including: Local revenue sharing - municipalities are entitled to receive a portion of some nationally collected revenue source, the amount of which is uncertain. This uncertainty about revenue levels translates into credit risk.

- Development fund institutions' default rates - the extent to which municipalities default when lent money by development fund institutions.

- Legal issues surrounding municipal default - the extent to which there is a well-defined legal or political process that clarifies what happened in the event of default.

- Economic conditions - economic risk depends upon a municipality's revenue and expenditure.

- Cross subsidisation - the extent to which revenue recovered from certain ratepayers for services will be used to subsidise non-recovery from other rate payers.

Generally, lenders have considered the creditworthiness of most municipalities other than the metropolitan municipalities to be lacking because:

- Municipalities may at times experience difficulty in effectively collecting revenue from the public to make timeous repayments of loans. This may be because municipalities have to provide water and sanitation services (as well as other services) to all South Africans, the majority of whom are poor and unable to pay for the municipal services provided to them. This may affect the ability of the municipality to collect revenue from the public.

- Some municipalities have experienced financial distress.

- Private lenders have found it difficult to use municipal budgets and municipal financial reports to gauge underlying financial condition so as to assess the credit risks involved in lending to the municipality.

The municipalities' liquidity (most municipalities are not always liquid).

Biddy Faber and Bridgett Majola

SPOUSAL CONSENT AND VALIDITY OF SURETYSHIPS

The recent decision of the Supreme Court of Appeal in Strydom v Engen Petroleum Limited (184/2012) [2012] ZASCA 187 (30 November 2012) serves as a reminder that it is important to remain cautious when entering into deeds of suretyship with individuals.

The facts of the case, briefly, are as follows:

- Soutpansberg Petroleum (Pty) Ltd (Soutpansberg) distributed petroleum products on behalf of the respondent, Engen Petroleum Limited (Engen).
- Soutpansberg was provisionally wound up on 13 November 2006. A final winding-up order was made on 12 November 2007. At that time it owed approximately R25 million to Engen.
- The Appellant was previously a director of Soutpansberg and had executed an unlimited deed of suretyship in favour of Engen, binding himself as surety for and co-principal debtor with Soutpansberg for amounts owing to Engen.

With a view to recovering the amount owed to it, Engen instituted proceedings against the Appellant in the North Gauteng High Court. The Appellant opposed the application on the grounds that he was married in community of property and that his wife had refused to give her consent to his signing of the deed of suretyship. He contended that the deed was therefore invalid by virtue of the provisions of s15(2)(h) of the Matrimonial Property Act, No 88 of 1984 (Act). This defence was rejected by the North Gauteng High Court, but the Appellant was granted leave to appeal to the Supreme Court of Appeal.

On appeal, the court noted that the Act did not abolish the institution of marriage in community of property. Instead, the Act abolished the vesting of the marital power in the husband alone and introduced a new legal regime governing marriages in community of property, where both spouses have the same powers with regard to, amongst other things, the contracting of debts which lie against the joint estate.

Section 15 of the Act, however, contains a number of limitations on the exercise of those powers. One such prohibition is contained in s15(2)(h), namely the prohibition on one spouse binding himself or herself as surety without the written consent of the other spouse, subject to the proviso contained in s15(6). S15(6) provides that 15(2)(h) does not apply where the suretyship is given by a spouse in the ordinary course of his or her profession, trade or business.

The court pointed out that where a business is carried on through an incorporated vehicle, such as a company or close corporation, or even an unincorporated vehicle, such as a partnership or trust, the question to be answered is whether the surety's involvement in that business is his or her business and whether the execution of the suretyship was in the ordinary course of the surety's business, not the business of the company, close corporation, partnership or trust. It may not, for example, be the surety's business if the surety is merely a salaried employee, having no commercial interest in the business' success or failure. However, a person who is a director of an incorporated vehicle or who has invested money to provide an incorporated vehicle with capital may be regarded as conducting business through that vehicle. In each case, therefore, it is a question of fact.

On the facts before the court, it was held that the Appellant failed to show that he did not bind himself as a surety in the ordinary course of his business and accordingly the appeal was dismissed with costs.

At the outset of negotiations with a surety, it must be ascertained whether the surety is married in community of property to ensure that the necessary written spousal consent is incorporated into the deed of suretyship, if required. In circumstances where such spousal consent cannot be obtained, consideration must be given to whether the surety is signing the suretyship in the ordinary course of his or her business to fall within the ambit of the exception provided for in s15(6) of the Act.

Jackie Pennington and Dayne Muller

THE CESSION OF SHARES AS SECURITY FOR A DEBT DOES NOT CONSTITUTE AN 'AFFECTED TRANSACTION'

In a recent funding transaction, where one of the lenders was also an existing shareholder of the borrower, we had to consider whether the takeover provisions of the Companies Act, No. 71 of 2008 (Companies Act) would potentially impact on the future enforcement of the cession of shares in the borrower and the general and special notarial bonds provided as security to the lenders (Security Documents).

Although the borrower, a private company, was not a 'regulated company' under the takeover provisions at the time of the conclusion of the Security Documents, there was a concern that the borrower may, at some stage in the future, become a regulated company if more than the prescribed percentage (10%) of its voting securities were to be transferred between persons who are not related or inter-related, for example, as a consequence of the enforcement of the cession of shares. In terms of the Security Documents it was envisaged that the borrower would mortgage its movable assets and its shareholders would pledge and cede their shares in the borrower as security in favour of the lenders. Designation as a regulated company would mean that for a period of 24 months after the borrower becomes a regulated company, transactions involving the securities of the borrower, including the enforcement of any of the Security Documents, could potentially be 'affected transactions' under, for example, s117(1)(c)(i) (disposal of all or greater part of the assets or undertaking of a regulated company) or 117(1)(c)(v) (intention to acquire all remaining voting securities in a regulated company). This would mean that such transactions could only be implemented after compliance with the takeover provisions and the issue of a compliance certificate or the granting of an exemption by the Takeover Regulation Panel (TRP).

It was our view that the execution, enforcement and/or foreclosure under the Security Documents would not constitute 'affected transactions'. However, because the takeover provisions in the Companies Act are wider in scope than was the position in the 1973 Companies Act, and having regard to the nature and magnitude of the finance involved, a decision was nevertheless made, as a matter of prudence, to apply to the TRP for an exemption from the takeover provisions. Such application was made on the basis that the exemption would apply if, at any stage in the future:

- the borrower becomes a regulated company and
- the lender seeks enforcement and/or foreclosure of the Security Documents while the borrower is so 'regulated'.

The application for exemption was premised on, among other things, the following grounds:

- there would be no 'offer' or 'offeror' in respect of the shares or assets of the borrower (were it to become a regulated company) pursuant to which the 'affected transactions' could possibly arise, because any acquisition arising out of the Security Documents would be the result of an enforcement or foreclosure pursuant to pre-existing security agreements and
- an exemption would be reasonable and justifiable in light of the principles and purposes of the takeover provisions.

In responding to the exemption application, the TRP concluded that the exemption could not be granted because the borrower was not a regulated company at the time of the application and it does not have the power to issue general or prospective exemptions. In addition and importantly, the TRP determined that the prospective cession of shares as security did not qualify as an 'affected transaction'.

It can accordingly be concluded, on the strength of the TRP's response, that the cession of securities as security in favour of a lender in a finance transaction does not constitute an 'affected transaction' and therefore the takeover provisions do not apply. A further relevant point is that the TRP only regulates specific transactions and one cannot apply to the TRP for an advance ruling in respect of prospective transactions or hypothetical scenarios which may or may not materialise in the future.

Izak Lessing and Pride Jani

APPLICABILITY OF SECTIONS 44, 45 AND 46 OF THE COMPANIES ACT, 2008

Lenders often ask which of s44, 45 and 46 of the Companies Act, No. 71 of 2008 (Companies Act) are applicable in particular circumstances. The applicability of these sections is considered in the following example (surety example) which occurs frequently in funding transactions: the lender lends money to one company in a group of companies (borrower) and obtains suretyships for the borrower's obligations from some or all of the other group companies (each a surety).

Section 45 deals with the giving of financial assistance by a company to '"a director or prescribed officer of the company or of a related or inter-related company, <u>or to a related or inter-related company or corporation,</u> or to a member of a related or inter-related corporation, or to a person related to any such company, corporation, director, prescribed officer or member"'. The section stipulates that a company may give the applicable financial assistance provided that a number of requirements are met. From the borrower's perspective and in the surety example it is a related or inter-related company in relation to each surety, each surety will provide financial assistance to the borrower by executing the suretyships and, accordingly, s45 applies.

Section 46 deals with distributions and provides that a company 'must not make' a distribution unless certain requirements are met. Section 1 of the Companies Act defines a 'distribution' to include both a cash distribution and the "incurrence of a debt <u>or other obligation</u> by a company for the benefit of one or more holders of any of the shares of that company or of any company within the same group of companies". Section 46(4) provides that if a distribution takes the form of an incurrence of a debt or an obligation, the requirements of s46 'apply at the time that the board resolves that the company may incur that debt or obligation'.

In the surety example the provision of a suretyship by each surety amounts to the acceptance of an obligation by the surety and if the borrower is the surety's holding company, the obligation is accepted for the benefit of a shareholder of the surety. The execution of each suretyship is accordingly a distribution as defined in s1 of the Companies Act and accordingly, s46 applies.

There is some debate around the situation where the borrower is a sister company of the surety. Here the obligation of the surety is accepted for the benefit of a company which is in the same group of companies as the surety's shareholder. Interpretation difficulties arise in the wording of paragraph (b) of the definition of 'distribution' where the incurrence of the obligations is for the 'benefit of one or more holders of shares of that company <u>*or of another company within the same group of companies'*</u>. If the underlined portion means the obligations are incurred for the benefit of any other company in the same group of companies, then clearly it constitutes a distribution and s46 applies. However, if this means the obligations are incurred for the benefit of <u>shareholders</u> of another company in the same group of companies, then the incurrence of a debt for the benefit of a sister company does not necessarily constitute a distribution (for instance if the sister company itself does not have another subsidiary). The likely (and conservative) interpretation would be the former, not least because otherwise the application of s46 could be easily circumvented by a company transferring money to another group company which is not a shareholder of another group company.

Less clear is the applicability of s44. This section deals with the provision of financial assistance by a company to any person for the purpose of any acquisition of securities by that person in either the company or in a related or inter-related company in relation to the company. The rules and requirements for the authorisation by the board of the company for the giving of such financial assistance are the same as under s45.

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Section 1 of the Companies Act defines 'securities' as 'any shares, debentures or other instruments, irrespective of their form or title, issued or authorised to be issued by a profit company'. The definition of 'securities' refers to shares, debentures and other instruments. It is not entirely clear what 'other instruments' are but, at least at common law, a 'debenture' is simply a written acknowledgment by a company in respect of monies borrowed. (The Companies Act does not define 'debenture'). Accordingly, if a lender lends money to a company, the loan arguably constitutes a 'security' under the Companies Act.

In the surety example the borrower will issue a security (the loan) to the lender, each other company in the group will provide a suretyship to the lender, the suretyships will constitute 'financial assistance', as envisaged in s44, given by the surety to the lender for the purpose of the subscription (by the lender) for securities in the borrower, and in such circumstances s44 applies.

Accordingly, in the surety example, each of s44, s45 and s46 apply.

(In terms of the literal rule of interpretation, the words used in the legislation are interpreted in their ordinary, literal, grammatical meaning. The ordinary meaning of words would not be followed where it would lead to absurdity or to such results that would not have been intended by the legislature. The above literal interpretation of 'securities' to include loans may have consequences that the legislature did not intend, for instance that securities must be evidenced by certificates or be uncertificated (s49 to 56). However, until the Companies Act is amended to the contrary, or the courts interpret the definition of 'securities' differently, the above (literal) interpretation of 'securities' would be prudent).

In practice, where there is doubt as to whether both s44 and 45 are applicable, the requisite (s44 and 45) resolutions do not need to refer to s44 and/or45 and accordingly, provided the resolutions comply with the requirements of those sections, the resolutions will satisfy both s44 and 45.

One should bear in mind that s44, 45 and 46 were written to deal with various different situations and they will accordingly not always overlap as comprehensively as they do in the surety example.

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