

Background briefing for Media

June 2015

Comair versus Ministers of Finance, Public Enterprises and Others North Gauteng High Court between 5 -14 May 2015 Case number 13034/2013

1. The Facts

In 26 February 2013: JSE listed aviation company, Comair Limited, launched a High Court legal challenge to then latest R5-billion government guarantee to South African Airways (SAA).

The R 5-bn guarantee was made on 16/9/2012 then converted to a perpetual guarantee on 29/11/2012. Comair is challenging both actions.

The case was heard between 05 -14 May 2015. Judge Fabricius's ruling will be handed down on 01 June 2015.

The respondents are the Ministers of Finance and Public Enterprise. Three banks joined the proceedings on 28 April 2015: Nedbank; Citibank and Standard Bank. ABSA also made loans to SAA and filed an answer but did not formally join the proceedings.

2. Bank Loans to SAA issued on the basis of the guarantee:

- Nedbank: R 1.8-bn
- Citibank: R 1.5-bn
- Standard Bank: R 1.5-bn
- ABSA: R 1.7-bn

The R 5-billion guarantee in 2012 was followed in December by an emergency loan of R550-million. At the end of 2012, SAA had received a total of R 22.687-billion in state aid. Since then SAA has received a further R6.43-billion state guarantee. See appendix 1

3. Background and Key Issues

- Existing national government policy requires SAA to operate on a sound commercial basis. See appendix 2
- Government guarantees enable SAA to avoid commercial realities. State subsidies enable SAA to artificially increase its scope of operations, sustain losses and adopt anti-competitive behaviour in the domestic market. This includes excessive capacity and discounting, and pricing at below cost. Under these anti-competitive

circumstances, privately owned competing airlines are unable to earn reasonable profits to allow them to cover operating costs, replace aircraft, provide a return to shareholders, and ultimately remain in business.

- As a direct result, the domestic airline sector has seen the demise of 10 out of 11 independent, private airlines since deregulation in 1991
- Fair competition is essential to achieve market-related ticket prices, product innovation and consumer choice.
- If government provides state assistance in the form of guarantees, then the taxpayers' representatives in Parliament should have oversight and authority *before* the deed is done and not after the fact as is the case with SAA.
- Any funding that will affect taxpayer funds should go through required parliamentary appropriation procedure before it is granted. Ministers do not have discretion to bind the fiscus to certain future expenditure without the approval of Parliament.
 - In the case of SAA, the airline was never going to be in a position to repay loans and therefore ultimately government, with taxpayer funds, would repay the loans from banks.
 - The ministers were of the view that SAA would never be able to repay the loans secured with the guarantees. Therefore the state support was not a guarantee by nature, but rather a device to delay the inevitable use of taxpayer funds.

3. Comair's Objective

Comair's sole objective is to attain a level playing field in the domestic aviation market to ensure that all airlines face the same risks and the same requirements to operate on sound commercial principles.

Comair seeks that:

1. Government will provide funding to SAA only after consultation with all affected stakeholders (required by the Promotion of Administrative Justice Act).
2. Any funding is in accordance with government's Domestic Aviation Transport Policy.
3. Any funding of SAA that will affect taxpayer funds now or in the future, go through the correct parliamentary budget appropriation process.

4. Domestic Aviation Policy (See Appendix 2)

Official government policy and legislation are in place which governs the operation of SAA as a state owned entity and its competitive relationship with the rest of the aviation industry. Comair contends that government guarantees do not comply with either the Domestic Aviation Transport Policy or the law (the Constitution, the SAA Act, the Promotion of Administrative Justice Act and the Public Finances Management Act).

5. Summary of key legal arguments

The Ministers (i.e. the Minister of Public Enterprises and the Minister of Finance) did not take into account the domestic air transport policy in deciding to issue the R 5 billion guarantees

- 1.1 The domestic air transport policy was first published in 1990 and thereafter confirmed and enhanced in various government documents over the years, including the current shareholder compact between Treasury and SAA. This policy indicates that there will be a level playing field in the domestic aviation industry, SAA will not enjoy special privileges, and specifically that government will not provide any form of funding to SAA while private airlines have to borrow at their own risk.
- 1.2 Comair contends that the decision to grant the Guarantee is contrary to this policy as it undermines the principle of level playing fields. The Minister should thus, at a minimum, have had regard to the policy and have had good reasons to deviate from the policy.
- 1.3 The Ministers accept that they did not have regard to the policy and argue that it was irrelevant to the decision to grant the guarantee. Amongst others, the Ministers argue that (i) the policy as reflected in the documents on which Comair relies was constantly in a state of flux and was not converted into law; it thus cannot be relied on in the manner that Comair seeks to do; (ii) the domestic air transport policy was produced by the Department of Transport (rather than DPE or National Treasury); (iii) it is a transport policy and not a policy that specifically applies to the exercise of the power to grant government guarantees under s 70 of the PFMA; (iv) the wording of the policy documents is not sufficiently emphatic to support Comair's contentions; and (v) it is clear that government had decided not to implement the policy on which Comair relies given the numerous instances of government financial assistance to SAA over the years.

2. The guarantee could not be issued where it was evident, or reasonably ought to have been evident, that SAA would not be able to repay the money loaned on the strength of the guarantee
 - 2.1 The parties agree that the guarantee was given to SAA (and subsequently extended to a perpetual guarantee) in circumstances where SAA was technically insolvent and would not be in a position to repay the loans to be raised on the strength of the guarantee.
 - 2.2 Given that the power to allocate government funds (the power of appropriation) is generally a legislative function (reserved for Parliament), Comair contends that the power to grant guarantees under s 70 of the PFMA may not be used where it is evident that government will have to make payment under the guarantee. In such a situation, the decision to issue the guarantee is essentially direct government funding which undermines the appropriation power of Parliament and thus contravenes the principle of separation of powers. It allows two ministers to effectively bind the fiscus without the approval of Parliament.
 - 2.3 The Ministers contend that there is no such limitation on the power to grant guarantees in terms of s 70 of the PFMA. They argue that the government may guarantee the debts of a state-owned entity even if it is "throwing good money after bad" and even if it is "a racing certainty that SAA could not repay the loans". Government can, according to the Ministers, issue a guarantee where the prospects of re-payment of the underlying loans are not good and even nil.
3. The Ministers did not agree on the conditions to which the guarantee was subject until several months later and after the guarantee had already been relied upon
 - 3.1 The undisputed facts are that the Minister of Finance communicated certain conditions attaching to the guarantee at the time that he agreed to the issue of a perpetual guarantee but these conditions were neither accepted by the Minister of Public Enterprises nor communicated to SAA until 11 months after the guarantee was purportedly issued.
 - 3.2 Comair contends that the failure to agree on the conditions attaching to the guarantee means that the guarantee was not validly issued (i.e. there was no proper concurrence). The Ministers are both required to agree on the applicable conditions.
 - 3.3 The Ministers and SAA effectively raise two arguments in response. The first is that, on interpretation of s 70 of the PFMA, the conditions attaching to the

guarantee are those imposed by the Minister of Finance (irrespective of whether or not the Minister of Public Enterprises agreed to the conditions). The second is that the Ministers subsequently agreed to the conditions, albeit 11 months later.

4. The decision to issue the guarantee was irrational and unreasonable

4.1 According to Comair, it was irrational and unreasonable to grant the guarantee in circumstances where the evidence showed that SAA would not be able to repay the loans raised on the strength of the guarantee. Even National Treasury's own internal committee expressed the view that the guarantee could not be justified on a financial basis. There is no evidence that the Ministers weighed any other considerations in deciding to issue the guarantee in the face of the overwhelming financial case against the guarantee.

4.2 The Ministers responded by arguing that the decision to issue a guarantee under the PFMA is a public finance decision, which must take into account not only financial considerations and that the decision to issue a guarantee to SAA and thereby salvage the airline was one that the Ministers could lawfully take. They argued that it is the type of decision with which courts should not generally interfere as it lies within "the executive heartland".

5. Comair and other affected persons should have been given an opportunity to comment prior to the decision to issue the guarantee

5.1 Comair contends that the domestic air transport policy gave rise to a legitimate expectation that entitled it to be heard prior to a decision to deviate from the policy (by issuing the guarantee). In accordance with the Promotion of Administrative Justice Act, Comair was thus entitled to make representations prior to the decisions to issue and then extend the guarantee in contravention of the policy. This is particularly the case where Comair had relied on the terms of the domestic air transport policy at the time of entering and making investments in the SA domestic aviation market. At the time of developing the policy, the then CEO of Comair participated in the task team that drafted the policy. The policy represented the rules of the game, which Comair chose to play.

5.2 The Ministers contend that Comair has not demonstrated that the requirements for a legitimate expectation were met. They contend that the expectation based on the wording of the policy was not clear and unambiguous, that any expectation was not reasonable, that the policy was not attributable to the Ministers (as it was a policy of the Department of Transport), and any

representation binding the Minister's discretion to act under s 70 of the PFMA would have been unlawful. The Ministers emphasise that Comair could not have a reasonable expectation that government would not issue a guarantee to SAA.

6. Additional arguments raised by the banks

- 6.1 Citibank and Nedbank argue that the R 5 billion guarantee does not exist as a guarantee only arises where a particular guarantee is issued to a specific bank.
- 6.2 Comair, the Ministers and SAA all argue that the banks are mistaken. The papers filed in the court proceedings demonstrate that a R 5 billion guarantee was issued to SAA. It was on the basis of this umbrella guarantee that SAA went to the market to raise loans backed by bank-specific guarantees. These bank-specific guarantees were issued in reliance on the pre-existing R 5 billion guarantee.
- 6.3 Nedbank (but none of the other parties) contends that Comair does not have standing to challenge the guarantee as a strict approach to standing should be adopted in public finance matters (so as to give effect to the principle of separation of powers). According to Nedbank, a private party cannot challenge a public finance decision under the PFMA (other than a procurement decision or a decision to impose a tax or levy). Nedbank further contends that Comair should have objected to Parliament before approaching the court.
- 6.4 Comair argues that Nedbank's contention has no basis in our case law, which adopts a broad approach to standing in constitutional matters. It would mean that no one other than government itself could challenge fiscal decisions of this nature, which would undermine accountability for public finance decision-making. In addition, it cannot be that Comair was required to first approach Parliament as Parliament was not in a position to remedy the situation. Comair's argument is that it was the Ministers who circumvented Parliament by committing government to pay out R 5 billion without following the requisite parliamentary process.

About Comair:

South African owned Comair Limited is SA's only domestic airline listed on the JSE. Proudly local, Comair has been operating successfully in this country for more than six decades with a safety record, which is internationally recognised. Since 1996, the company has been the local franchise partner of British Airways Plc operating under British Airways livery in Southern Africa. Comair also operates Africa's first low-fare airline, kulula.com, started in 2001. Since inception, this adventurous brand has revolutionised air travel in South Africa by

making flying much easier and more affordable to customers. For more information, visit www.comair.co.za.

Appendix 1

Government funding of SAA to December 2012 (pre Comair Challenge)

- Pre 2007 Prior to transfer of SAA to DPE in 2007 R 13.635-bn
- March 2007 Solvency guarantee – fully drawn down R 1.3-bn
- March 2008 Funding of B747-400 retirement R 1,549-bn
- March 2008 Labour restructuring grant R 653-m
- Sept 2009 Going concern guarantee – not drawn down R 1.6-bn
- Oct 2012 Guarantee R 5-bn
- Dec 2012 Emergency loan R 550-m
- **Total R 22.687-bn**

Appendix 2

Government funding of SAA to current

2014 – 2015

1. Since the 2012 R 5-bn guarantee, government has provided an additional guarantee of R6.488 bn to satisfy the auditors that SAA is a going concern. This plus the 2012 R 5-bn brings the total in bailouts to R 14.394 billion and includes:
 - i. 2007: R 1.3-bn
 - ii. 2009: R 1.6- bn
 - iii. 2012: R5.006-bn billion (includes R600K to save immediate cash flow crisis)
 - iv. 2015: R 6.488 billion

Over 20 years, government has bailed out SAA to tune of R 30.5 billion in guarantees, loans and grants

Appendix 3

Domestic Air Transport Policy (DATP) (custodian: Department of Transport)

Designed to effect the deregulation of the domestic market in 1990 and encourage private airline participation and includes:

- ➔ Domestic Air Transport Policy (MAY'90)
- ➔ Addendum to the Domestic Air Transport Policy (AUG'91)
- ➔ White Paper on National Transport Policy (20AUG'96)
- ➔ Airlift Strategy (JUL'06)

Key Points

- 1990 DATP: key principles:
 - Safety through quality operators
 - Economic decisions should be left to competitive forces to resolve
 - Users interests should be considered
 - All participants should be treated equally regarding:
 - entry into the market, capacity, fares, routes, exit from the market, government contracts,
 - financial support, reciprocal privileges, the rendering of uneconomical services, the strategic value of aircraft (and more)

- **1991 Addendum to DATP**
 - SAA must operate autonomously and on a commercial basis.
 - SAA must be prevented to use profits made on its international services to subsidise its domestic services.
 - SAA will not enjoy any privileges in terms of any legislation or any other practices as a result of it being a Government enterprise.
 - Government will not guarantee new loans to SAA or any other airline with Government interest, whilst private airlines have to borrow at their own risk.

- **1996 White Paper on National Transport**
 - Confirmed the principles of 1990 DATP
 - Identified the following strategic objectives:
 - Civil aviation policies should encourage participation in the aviation industry by creating an environment where investors can realize adequate returns on their investment
 - Economic decisions should, as far as possible, be subject to general competitive principles applicable to all industries, with a view to maximizing consumer choice and needs satisfaction.

- **1996 Department of Transport Airlift Strategy**
 - “...Government is well aware that the issue of inappropriate state funding has been the subject of intense discussion in a number of fora, including the ICAO [the International Civil Aviation Organisation] 5th World Wide Conference of March 2003. ...
 - In this context, Government has already adopted a number of measures to address the economic and commercial stability and sustainability of SAA within the context of our own air services policy.
 - Inter alia, these include:

- The transfer of SAA out of Transnet by end of 2006. Consistent with the White Paper on National Transport Policy 1996
- The current unbundling of SAA from Transnet should ensure equal treatment of all participants in the air transport market as well as ensuring that SAA operates efficiently, effectively and on a sound commercial basis whilst positioning itself to taking up opportunities in the liberalising African skies as well as generally servicing the global market.”