



PRECIUM
INVESTMENTS

Understanding South Africa's Expropriation Bill

In Precium's analysis of the Expropriation Bill (2018), we detail the following: the challenging and technical processes involved in expropriation (Section 1), the key issues with the Bill in its current format (Section 2), as well as the potential impact on the banking and financial services sector and how that impact could be mitigated (Section 3).

Section 1: The Challenging Processes Involved with Expropriation

The Expropriation Bill¹ (the "Bill") is about expropriation of all forms of property in the "public purpose or public interest". The Bill's definition of property includes land, but isn't limited to just land, as the definition also includes buildings, immovable assets, roads & intellectual property². Additionally, it is more accurate to understand that the Bill deals with expropriation WITH compensation primarily, with just a few instances where expropriation WITHOUT compensation can be legitimately pursued.

As the Bill currently stands, there are numerous barriers and challenges to the speed at which expropriation can take place. Precium has created the accompanying infographic (found at the end of Section 1) in order to visualise the steps discussed below. The infographic references specific parts of the Bill where these steps are drawn from

The following steps are a high-level overview of the process for expropriation as set out by the Bill -

Step 1: an individual or legal entity makes a claim on a property, or the Expropriating Authority, who could act on its on behalf or on behalf of the individual or legal entity. The Expropriating Authority ("EA") is defined within the Bill as the Department of Public Works, but technically could also be a municipality or other organ of state.

Step 2: The property to be expropriated must then be valued by a professional valuer (in terms of the Property Valuers Act). If that property is currently owned and occupied, the occupant can technically refuse entry to the property valuer. The claimant would then need to get a court order to force the occupant to allow entry into the property and begin the process of assessing and valuing the property.

Step 3: Now, if that property is land, the claimant may additionally have to consult with one or more of the following four departments: rural development and land reform, environmental affairs, mineral resources and water and sanitation, as well as any municipality and any other organ of state whose functions and responsibilities will be "materially affected" by said expropriation. During this stage, any of these departments or organs of state can express the first set of challenges to a potential expropriation.

Step 4: Get through those challenges and the EA must then serve something called an 'Intention to Expropriate' to the property owner(s). New objections to the Intention to Expropriate can be lodged by the owner, or any organ of state, at this point. This may happen, for example, on the basis that the amount of the compensation being offered is not being 'just and equitable'.

¹ Expropriation Bill of 2018, as published on the 21st December 2018, in the Government Gazette No. 42127 - http://pmg-assets.s3-website-eu-west-1.amazonaws.com/Draft_Expropriation.pdf

² Section 1.1(c) of the Bill

Step 5: A period of negotiation and mediation could potentially follow, along with counter offers from the owner or organ of state to the EA. If any challenge isn't resolved through mediation, a court intervention will likely be necessary.

Step 6: Once mediation or the court process has concluded (if it is in favour of the EA or both parties agree), the expropriation continues. Now, something called a 'Notice of Expropriation' is issued and delivered to the property owner, the creditors (where the property has been pledged as security) and any organs of state or government departments affected.

Step 7: Once the due compensation is paid to all required parties, the property ownership then moves to the claimant.

Step 8: However, even after the property is expropriated in this manner, the expropriation process may still not be fully concluded. If it is discovered that there are unregistered rights claims (i.e. a right to use land which was not required to be registered) against that property, there is another specific process dealing with how to deal with these claims³. If these rights are assessed by the EA as valid, compensation has to be paid to this party/these parties too.

It is important to bear in mind that around each of these steps, there's a fairly prescriptive process to be followed, with possibilities for time extensions permitted at each step⁴. This can add additional time spent in courts and the 20-40 day notice periods allowable for some of the various steps in the process.

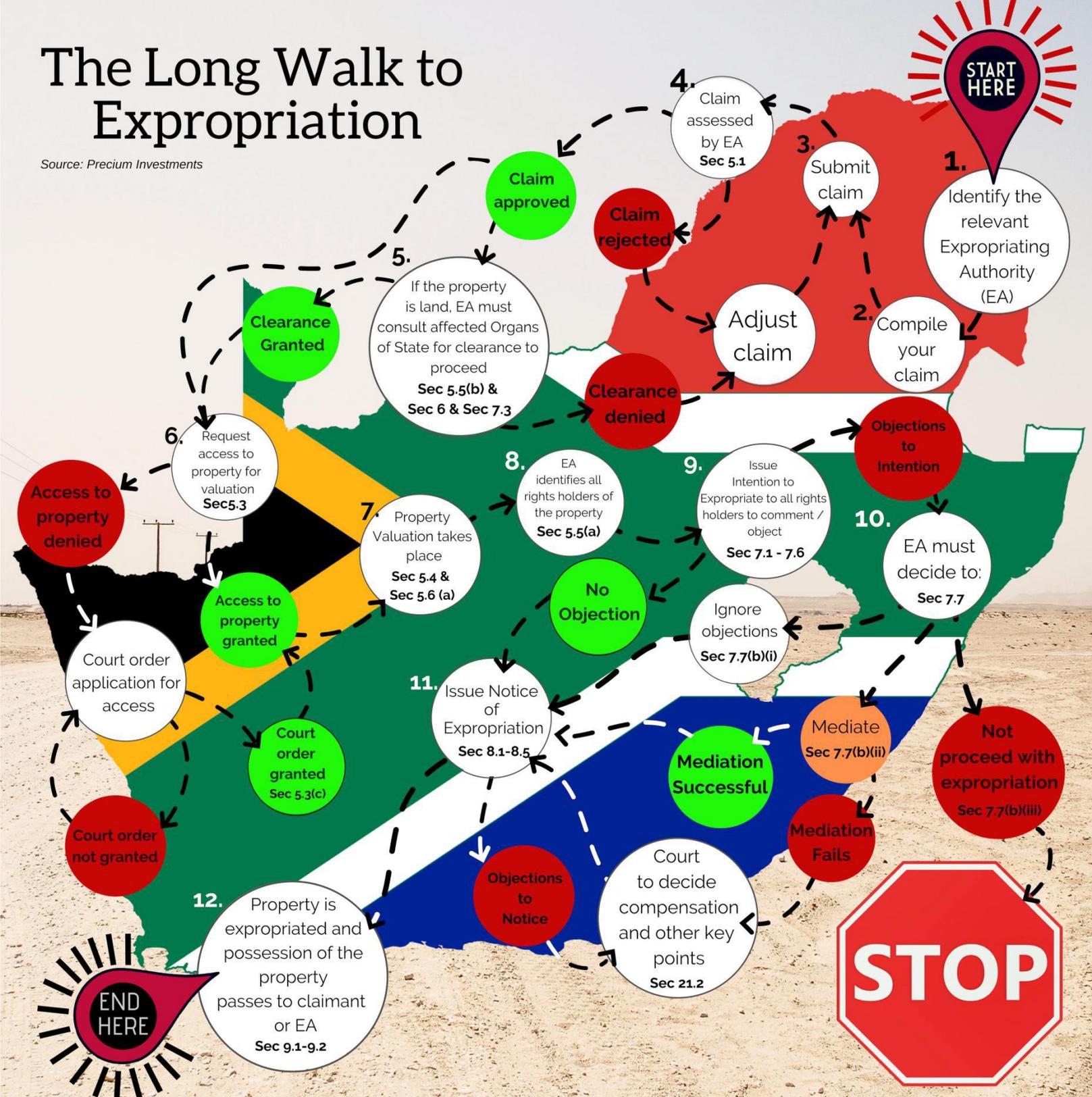
This lengthy and complex expropriation process seems to support one of two obvious interpretations. Option one is that this Bill is something that just so happens to be very poorly drafted, given the stated objective of land reform and property distribution. Option two is that the Bill isn't poorly drafted at all, and it serves its purpose well, it's just that the purpose would be to capture votes whilst not changing the status quo too much.

³ Section 10 of the Bill

⁴ Section 25 of the Bill

The Long Walk to Expropriation

Source: Precium Investments



Section 2: Key Issues with the Expropriation Bill

The debate surrounding expropriation does have value when it allows one to find differing perspectives in order to develop a more nuanced view of the subject being debated. However, one should not make the mistake in thinking that there is value in having any debate where there are no core shared values between the parties debating, in regards to the subject that they are debating about. As an example, if one imagines that it was your central goal to build South Africa into a racially integrated and harmonious society it would not add value to have a debate on this goal between people who see this as a valid goal, and those who see white supremacy as a legitimate point. The absence of shared values makes debate meaningless. Productive debate is where all parties, despite any other differences, start from the position of having a common goal and shared base values, even if their methodologies to achieve that goal differ.

In terms of the issue of expropriation, slow progress is a luxury that only those in comfortable and privileged positions can afford. For those whose houses are metaphorically on fire, solutions need to be far more immediate and drastic. In South Africa, a majority of the population have no or limited access to capital and participation within the economy. This is the 'house on fire', and adds to a country that is structurally unsound from a social perspective. Asking those without this type of access to continue to wait is a high-risk strategy, and one that is unlikely to bring much long-term benefit for any grouping, regardless of their income level.

One's support or opposition to the principle of expropriation is directly related to how closely one's value system aligns with the idea that a good society is one that creates equal opportunities for those within it. This is not to say that there shouldn't be competition within society, but rather that those competing should start at the same starting blocks. In order for any individual to have self-sufficiency, economic mobility and freedom from poverty, access to capital is paramount. Expropriation without compensation is a concept that is about creating historical redress and additionally and importantly, giving people access to capital (in this case, capital in the form of property and land).

The Expropriation Bill however, in its current form, contains some critical issues. Here below are the seven most critical issues:

Issue 1: Property owned by any state-owned entity ("SOE") can't be expropriated without the agreement of the relevant ministers who are the SOE's ultimate authority⁵. This creates an issue because it creates a special, protected class of property for SOEs, and exempts them from the expropriation process unequally. When consent for expropriation is required, it is no longer accurate to define that as expropriation. Rather, one should call that process by its proper term: a sale of property.

⁵ Section 2.2 of the Bill

Issue 2: There is a requirement for a claimant to prove that he has tried to acquire the expropriated property on “reasonable terms”⁶ prior to any expropriation taking place. In the absence of a clear definition for what “reasonable terms” means, expropriations are likely to be opened up to legal challenges.

Issue 3: Any organ of state can approach the Minister of Public Works (under whom this Bill has been put forward to parliament) to expropriate property on its behalf⁷, so long as it does so in the ‘public interest’. As there currently isn't a clear definition of what ‘public interest’ constitutes, this would grant the state very wide ranging powers to seize property on its own behalf, as opposed to on the behalf of citizens who may require it.

Issue 4: Mining rights are a protected and special form of property that is fully exempt from expropriation⁸. Similar in a way to the protections for SOEs, this special treatment for the mining sector, over and above citizens and other business sectors is unfair and without merit.

Issue 5: Creditors Rights - There is great confusion created by Section 9.1(d) of the Bill as to whether mortgaged property becomes freed of the mortgage upon expropriation (meaning that bank/debt holders would have to write off their debt on that property), whether the debts would be settled in full by the expropriating authority, or whether or not said mortgage would transfer to the new property owner, which would have the effect of encumbering them with debts that they did not grant over their newly gained property. There are major implications of all interpretations, but the way that the Bill is currently drafted, this critical issue is unclear.

Issue 6: Compensation for Expropriation - Sections 12 - 17 of the Bill make reference to calculating the value of property, whilst including something called a “just and equitable” calculation, in regards to valuation. The practical challenge is that there is no known consistent financial methodology to quantify justice and equity. If, for example, the commercial value of a property is R10m, what would the discount attributable to justice and equity be? Is there a R8m discount for justice and equity applicable in this case, bringing the compensation required down to R2m? Without any methodology put forward within this Bill, it will require definition by one or more judges, as cases are disputed in courts.

Section 12.3 details the times where it may be “just and equitable” for no compensation to be paid where land is expropriated. The word “land” is used and not the word “property” (which has a far wider definition) when referring to expropriation without compensation taking place. Section 12.1 which deals with compensation for expropriated property does not use the term “land”, but rather deals with “property” throughout its clause. The manner in which these clauses are drafted suggests that nil

⁶ Section 2.3 of the Bill

⁷ Section 3.2 of the Bill

⁸ Section 9.1.(b).ii of the Bill

compensation for property is to be treated differently to land and that perhaps it may only be land that is expropriated without compensation.

Issue 7: Section 26 of the Bill discusses the Expropriation Register (a register which would contain all the details of expropriations, intended expropriations, etc.) which is to be maintained by the Director-General of Public Works. If ever there was a point vulnerable to corruption, it would be this. There is no mention that there should be, or that there is a requirement for, any transparency or public oversight of this register, although I imagine that utilising the Promotion of Access to Information Act may create some opportunity for interested parties to access this register.

These key issues, if addressed, would close the gaps within this Bill and would at least enable a more efficient and balanced legal framework for the issue of expropriation.

Section 3: The potential impact the Bill could have on the banking and financial services sector and how that impact could be mitigated

The possible complexities that exist in regards to expropriation without compensation and its impact on the banking and financial sector are significant. The Bill deals with expropriation both with and without compensation but it is not expropriation as a whole that would present the largest challenges, but more specifically expropriation without compensation that would offer up the largest challenges to the financial sector. Where there are challenges however, so too are there potential solutions. This section examines some of those possible challenges and solutions.

Event of Default Clauses

First, a quick primer to any readers who aren't familiar with the intricacies of the banking and financial services sectors. Banks (like many financial institutions) raise funding through borrowing money (e.g. from other banks, insurance companies, pension funds, sovereign wealth funds, etc.). When a bank borrows, those whom it borrows from typically insist on having what is known as 'event of default' clauses written into their lending agreements. Such clauses give lenders the right to immediately take their money back if certain events happen prior to their money being fully repaid. With that in mind, if any South African financiers have event of default clauses related to expropriation in place from their lenders, which clause can be interpreted to mean that expropriation without compensation is a trigger for an event of default, then that specific chunk of debt can be taken back immediately. This could be a sizeable issue, but in order to understand that accurately, one would have to look at each bank's outstanding funding agreements so as to get an accurate sense of exactly what the risk factor is here.

Capital Adequacy Requirements

Secondly, South African banks are subject to various regulations and laws: the Banks Act, the SARB Act, and the Basel 3 regulations (which have been voluntarily adopted as policy by the SARB and SA banks). A quick note on Basel: the Basel regulations, created by the Basel Committee, are an international (and voluntary) regulatory framework on banking regulations. The Basel Committee, which create these regulations and is an extremely powerful voice within banking, started in the 70's with the idea of creating globally consistent banking regulations. The first committee was created from the central bank governors of the major colonist countries, plus Sweden, Switzerland, the US and Canada). These various regulations specify what a bank's capital adequacy ratio should be. Simply understood, a capital adequacy ratio is the minimum amount of capital (in various forms) that a bank needs to keep on hand at any given time, given the amount of assets it has, and the level of assessed risk of those assets. The thought process that drives this ratio, is that banks should be stable so as to protect depositors' money, and keep financial systems stable, which are good goals. However, financial systems are not designed with the creation of justice in mind, but rather to ensure stability. Whilst the stability of financial systems have implications for the amount of equality and justice that is present in a society, it is important to note that that isn't their central goal.

Should banks begin to not be paid back or fully settled for the money they have lent out to the owners of property which has been expropriated without compensation, there is a domino effect which becomes possible. Banks' bad debts levels are likely to rise, which could then threaten their capital adequacy ratio. If there are events of default, and the banks' lenders call for an immediate return of their capital, this too can cause a worsening of their capital adequacy ratio. Whilst this situation deteriorates for banks, the banks will need to make up for this increasing gap (so as to not be in breach of the law). Some solutions from a bank's perspective, may be to try and raise new shareholder and institutional funding. It is quite likely that the price of the new capital will come at a higher cost, given the perceived increased risk. This in turn means that banks would possibly raise the pricing of capital lent out to their customers. When there is an overall increase in the cost of capital within the economy, there is less borrowing and spending, and a shrinkage of growth. There is also a worse scenario than the one described above, where there are closures of banks as a result of their inability to raise sufficient new capital, causing them to be in breach of the relevant regulations.

There are always possible solutions available, even if they are not easy. Amendments to banking regulations could be made to take into account the impact of expropriation without compensation, so as to create a better balance between banking stability and the needs of the South African citizenry. Of course, any move away from Basel 3 regulations, as voluntary as they are, would require an intense amount of education and engagement with all global credit ratings agencies and the Basel committee. They would have to be made to understand that any move away from these regulations, and substitution with SA specific regulations, would be created in such a way as to not fundamentally increase the risk of default by banks.

Where some only see fear or insurmountable challenges as a result of expropriation, one should keep in mind that innovation borne out of necessity often creates tremendous solutions. The world is better off when decision makers act with intelligence, creativity, empathy and attention to detail in order to build a more progressive society. Unfortunately, this Expropriation Bill cannot be viewed as an expression of those factors.

expropriate

/ɪks'prəʊpriət,ɛks'prəʊpriət/

verb

(of the state or an authority) take (property) from its owner for public use or benefit.
"their assets were expropriated by the government"

Similar: [seize](#) [take away](#) [take over](#) [take](#) [appropriate](#) [▼](#)

- **dispossess (someone) of property.**
"the measures expropriated the landlords"