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**‘The requirements for, and appropriateness of, stopping the equitable share of
municipalities in terms of section 216’**

WESTERN CAPE

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Submission date: 26 February 2016

DECLARATION

I, Naushina Abdool Rahim declare that **‘The requirements for, and appropriateness of, stopping the equitable share of municipalities in terms of section 216’** is my own work, that it has not been submitted before for any degree or examination in any other University, and that all the sources I have used or quoted have been indicated and acknowledged as complete references.

Student: Naushina Abdool Rahim

Signed:



**This thesis is dedicated to the loving memory of my grand parents
Nani and Nana.**



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Fiscal capacity

Intergovernmental dispute with the National Treasury

Intergovernmental transfers

Stopped LES transfers

Municipalities

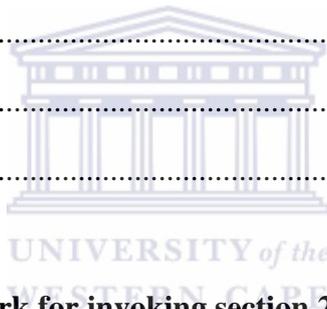
Basic services

Treasury



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Chapter 1

Introduction

1. Problem statement

Section 227 of the Constitution of the Republic of South Africa, 1996 (hereafter referred to as the Constitution) provides for national sources of provincial and local government funding in the following manner:

- (1) Local government and each province—
 - (a) is entitled to an equitable share of revenue raised nationally to enable it to provide basic services and perform the functions allocated to it; and
 - (b) may receive other allocations from national government revenue, either conditionally or unconditionally.
- (2) Additional revenue raised by provinces or municipalities may not be deducted from their share of revenue raised nationally, or from other allocations made to them out of national government revenue. Equally, there is no obligation on the national government to compensate provinces or municipalities that do not raise revenue commensurate with their fiscal capacity and tax base.

[Date of commencement of s. 227: 1 January 1998]

This means *inter alia* that the local government sphere is entitled to an equitable share of funding raised nationally, without any conditions attached.¹ In the South African local government sphere in general, metropolitan municipalities in particular, are financially self-reliant providing for over 70 per cent of its expenditure from internal sources of revenue.² The equitable share is however a vital source of revenue especially for many rural municipalities whose economic base does not garner much revenue from its own support base. Such municipalities cannot undertake their constitutional duty of providing basic services without the revenue they receive in the form of the equitable share. Section 216(1) of the Constitution states that:

¹ S 227 Constitution of Republic of South Africa, 1996.

² Steytler N & De Visser J (2012) *Local Government Law of South Africa* 12-5.

national legislation must establish a national treasury and prescribes measures to ensure both transparency and expenditure control in each sphere of government, by introducing-

- (a) generally recognised accounting practice;
- (b) uniform expenditure classifications; and
- (c) uniform treasury norms and standards.

(2) The National Treasury must enforce compliance with the measures established in terms of subsection (1), and may stop the transfer of funds to an organ of state if that organ of state commits a serious or persistent material breach of those measures.

The Constitution therefore authorises the National Treasury (hereafter referred to as NT) to stop transferring revenue to municipalities under certain conditions. Service delivery would therefore be seriously compromised in such municipalities if the equitable share is stopped for whatsoever reason.

In 2015, the National Treasury withheld the equitable share of almost a quarter of the total number of municipalities in the country by invoking section 216(2). The NT has done so because the municipalities failed to make good on their debts: in particular failed to pay two main creditors, Eskom and the water boards, the suppliers of electricity and water respectively.³ The municipalities that are implicated in this matter are mostly rural municipalities which, as mentioned above, have a very low own-revenue base and, therefore, are reliant on the equitable share as their main source of income. Even more, residents in those affected municipalities mainly consist of poor rural communities who depend on their municipalities for the delivery of free basic services, simply to survive.

On 31 March 2015, NT issued a media statement titled: *National Treasury withholds transfers to 60 municipalities*. An extract from the statement is quoted below:

National Treasury has, with effect from 20 March 2015, withheld the transfer of equitable share to municipalities due to failure to honour their financial commitments in general and

³ Eskom is owed R9 billion and water boards owed R1.3 billion of which half is current and the other half owed in arrears (FFC presentation to Standing Committee on Appropriations on withholding of LES allocations, 29 July 2015).

to pay Eskom and other service delivery creditors in line with section 65 (2) of the Municipal Finance Management Act, 2003 (MFMA, Act No. 56 of 2003). Section 216 (2) of the Constitution permits the National Treasury to stop the transfer of funds (equitable share 1 and conditional grants 2) to any organ of state that commits persistent and material breach of their financial obligations. The persistent failure by some municipalities to pay creditors within 30 days amounts to financial mismanagement and the National Treasury deems it important to take steps to ensure that municipalities meet their financial commitments. Municipalities, as at 31 December 2014, owed ESKOM R9 billion, of which R4.5 billion is current and the balance relates to arrears, which is a persistent breach of the payment terms applicable to creditors. Municipalities, as at 31 December 2014, owed Water Boards R3.6 billion, of which R1.3 billion is current and R2.3 billion relates to arrears which is a persistent breach of the payment terms applicable to creditors. Early in March, National Treasury, informed municipalities with persistent arrears in respect of ESKOM and Water Boards, of its intention to invoke Section 216 (2) of the Constitution, subject to municipalities entering into repayment arrangements with these creditors and preparing a financial recovery plan where relevant.⁴

The NT said the reason it chose to withhold the equitable share from the municipalities was to address the growing culture of non-payment by municipalities, with debt increasing annually to levels higher than the budgets of some municipalities.⁵ It also highlighted that outstanding debt to Eskom and water boards were not prioritised for payment by municipalities, indicating that the equitable share was not being used to pay for services.⁶ Officials at NT were concerned that the money owed to Eskom and water boards, amounting to billions of rands, would put the creditors in a vulnerable position and also put the country's economy at risk. The NT thus set the condition that it would resume transferring the equitable share to the affected municipalities concerned once payment agreements had been entered into with Eskom and the water boards.

⁴ Retrieved on 22 Feb 2016, http://www.treasury.gov.za/comm_media/press/2015/20150331%20-%20National%20Treasury%20Withholds%20Transfer%20of%20Funds%20to%2060%20Municipalities.pdf

The number of municipalities affected went down from 60 to 59 since 13 May 2015, therefore the number referred to henceforth in this paper will be 59, see www.parliament.gov.za.

⁵ National Treasury presentation to Portfolio Committee on Cooperative Governance and Traditional Leaders on debts owed to Eskom and Water Boards, 12 May 2015.

⁶ *Ibid.*

The decision of the Treasury to stop the transfer of the equitable share to the municipalities did not pass without criticism. Many questioned both the constitutionality and the appropriateness of the measures taken by the Treasury. For instance, the South African Local Government Association (Salga) declared an intergovernmental dispute with the Treasury over its decision not to release the equitable share to affected municipalities.⁷ Salga stated that it viewed the decision as illegal: and the manner in which the decision was taken and implemented inappropriate. According to Salga, the NT sent an email to the affected municipalities on 6 March 2015 stating that the municipalities had until 13 March 2015 to settle any outstanding debt with Eskom and the water boards. Failure to do so meant their equitable share would be withheld. And on 20 March 2015, the Treasury withheld the equitable share of 60 municipalities. SALGA protested that such a swift measure was inappropriate given the fact that the municipalities were already in a financially dire state and unable to make good on their debt as per the NT's instructions. It also stated that the Treasury's actions went contrary to the guidelines set in the Intergovernmental Relations Framework Act 13 of 2005. Furthermore, the municipalities themselves were owed a lot of money by national, provincial and other entities of which they were not paid.⁸

The Financial and Fiscal Commission (FFC) submitted a report to Parliament questioning the appropriateness of the NT's decision to withhold the equitable share from municipalities seeing that the effect of this measure would be akin to "hitting the innocent and the guilty alike".⁹ By 'the innocent', the FFC meant the fee-paying-residents of the affected municipalities as well as those receiving free electricity and water, who would be unfairly cut-off from receiving their basic services. The FFC submitted that NT should not have focused only on penalising the municipalities for non-payment of debt but should also have used the same strict measures on the entities owing revenues to the municipalities.¹⁰

Furthermore, Deputy Director-General and National Transfer Officer in the Department of Cooperative Governance and Traditional Affairs (CoGTA), Muthotho Sigidi also questioned the manner in which the decision was taken NT. In practice, the Finance Minister should inform his co-operative governance counterpart of any decisions before implementing it. In

⁷ Ferreira E. 'SALGA declares dispute with Treasury over Eskom debt' *Mail & Guardian* 14 May 2015.

⁸ See Fiscal and Financial Commission (FFC) submission on stoppage of local government equitable share allocations, 24 May 2015.

⁹ *Ibid.*

¹⁰ *Ibid.*

this instance, Finance Minister Nhlanhla Nene did not inform his co-operative governance counterpart Pravin Gordhan before notifying municipalities of stopping the equitable share; but rather he was only informed of the decision after the NT had already sent the warning notice to the municipalities in arrears.¹¹

2. Research questions

This is the first time that NT has invoked section 216 of the Constitution in order to withhold equitable shares from such a large number of municipalities. Even more, it withheld the equitable share by alleging that the municipalities failed to make good on their debts. A cursory reading of section 216 of the Constitution shows that non-payment to creditors is not among the grounds that are provided for withholding equitable shares from financially malfunctioning municipalities. This leads to two important questions:

The first question is: Was the decision of NT to withhold the equitable share of the 60 municipalities by alleging that they failed to make good on their debts constitutional and legal?

The second question is that, even if the decision is not contrary to any constitutional or statutory provision, were the measures taken by the Treasury appropriate given the adverse effect the decision would have on the residents of the affected 60 municipalities and the impact on the defaulting municipalities. The right to access to water¹² and even the right to electricity as a basic municipal service¹³ is asserted through the Constitution and the Constitutional Court respectively. When using an intervention measure that renders citizens in a vulnerable position where their access to basic services is concerned and also the service provider, in this case the municipality is placed in a vulnerable position, it is important to be sure that the intervention measure is one that is worthy of being used. In essence, what is the value of using this kind of financial intervention against defaulting municipalities?

3. Argument

¹¹ Portfolio Committee meeting minutes (12 May 2015) retrieved from <https://pmg.org.za/committee-meeting/20884/> (accessed on 01/06/2015).

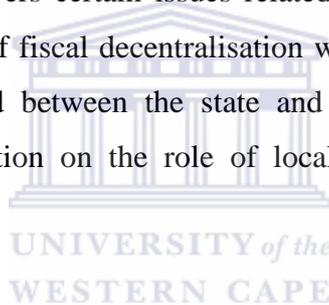
¹² S 27(1)(b) Constitution.

¹³ *Joseph and Others v City of Johannesburg and Others* (CCT 43/09) (2009) ZACC 30 at para. 34.

It will be argued that the decision taken by NT was not in line with the constitutional and legal requirements for invoking section 216. Although the substantive requirements have been met, there are several procedural issues that put the measure taken by NT into question. Furthermore, addressing the issue of appropriateness, several factors are indicative that the decision of withholding the equitable share is inappropriate. Section 216 being used as a first resort has placed paying residents and indigent consumers in a vulnerable position. Municipalities themselves are placed in a grim position; apart from the risk of water and electricity being cut-off to their residents, without the equitable share other services to residents are also jeopardized.

4. Literature Review

There is some literature that covers certain issues related to the main topic. The available literature focuses on the nature of fiscal decentralisation which underpins the entire practice of how revenue can be divided between the state and subnational units. The available literature also provides information on the role of local government in delivering basic services.¹⁴



There is a dearth of scholarly literature on when and how section 216 of the Constitution can or should be invoked to withhold revenue from municipalities. Steytler and De Visser in the *Local Government Law of South Africa (LGLSA)*¹⁵ briefly highlight the procedural requirements to be followed when invoking section 216 as detailed in the Local Government: Municipal Finance Management Act, 56 of 2003 (MFMA). However, Steytler and De Visser have not included an in-depth analysis of the issue of substantive requirements for invoking section 216.

Very little has been written on whether it would be appropriate to invoke section 216 under all circumstances, even when it is certain that a decision taken under section 216 is lawful. The only reference to the issues linked to effectiveness and appropriateness can be found in government documents and submissions to Parliament.

¹⁴ Cameron R (2002) 'Central-Local Financial relations in South Africa' *Local Government Studies*, 28(3) 113-134.

¹⁵ Steytler N & De Visser J (2012) 15-65.

All other intervention methods into municipalities, including a financial intervention in terms of section 139 of the Constitution have been well researched, as evidenced in De Visser's textbook,¹⁶ although very little has been written on halting the equitable share payment in terms of section 216. The reason for this perhaps is because it is the first time that NT has invoked this section to halt the equitable share payment and has done so on such a large scale. An in-depth analysis into what constitutes the meaning of sub-sections contained under section 216 (1) is sorely needed under the current circumstances; invoking section 216 for non-payment to creditors needs to be established as a ground for using the section as it is not found listed in subsection 1. A decision that is made by NT in terms of the Constitution needs to be done in a manner which follows the correct substantive and procedural measures as provided. Therefore it is submitted that this study will contribute to the use of section 216 for future and also under present circumstances.

5. Chapter outline

This thesis is divided into five chapters. This chapter is the first and serves as an introduction.

Chapter two analyses section 216 of the Constitution with a view to determining when this section can be invoked, and together with relevant sections from the MFMA the legal framework for invoking section 216 is prescribed. The substantive requirements as well as the procedural requirements in terms of the financial intervention application will be expanded on in the next chapter.

Chapter 3 examines the legality of withholding an equitable share payment by the National Treasury in light of the substantive and procedural requirements under the Constitution and other relevant laws.

Chapter 4 examines the value of using section 216 in addressing the issue of defaulting municipalities, the effectiveness and the appropriateness of NT's decision.

Chapter 5 is a concluding chapter with findings and recommendations.

¹⁶ De Visser J (2005) *Developmental Local Government: A Case Study of South Africa*. 192-197.

6. Methodology

The research for this paper has been done mainly through desktop research. The following research materials were used: primary sources such as the applicable legislation, government reports and case law. Further, secondary sources such as academic articles and newspaper articles were used. The basic financial information on the impact of the stopping of transfers was obtained by means of a telephonic interview with a municipal official. The telephonic interview was held with Ms Esmarie Hall (Manager of Municipal Expenditure at Ventersdorp Local Municipality (NW401)) on 17 July 2015.¹⁷



¹⁷ Minutes available upon request from Ms Naushina Abdool Rahim [n.abdoolr@gmail.com].

Chapter 2

The legal framework for invoking section 216(2)

1 Introduction

The National Treasury, by invoking its power under section 216(2) of the Constitution withheld the Local Government Equitable Share (LES) of 59 municipalities¹⁸ by alleging that these municipalities had failed to pay their debt to two of their major creditors¹⁹ - Eskom and the water boards which are responsible for providing bulk services of electricity and water to the municipalities respectively in terms of a service agreement.²⁰

The first issue this research paper seeks to address is whether the withholding of the LES was lawful both in terms of the Constitution as well as applicable legislation. There are specific substantive and procedural requirements that must be met to ensure the constitutionality of this particular decision. This chapter provides an interpretation of both the substantive provisions as well as the procedural provisions under section 216.

This chapter will begin by first discussing the autonomy of local government, the need to do so is because local autonomy is the principle upon which South African governance is based. Supervision is the exception to this autonomy and is a mechanism incorporated into the system in order to avoid the negative consequences of an unfettered local autonomy. The

¹⁸ For arrears debt, municipalities in Mpumalanga, Free State and North West top the list as the municipalities in these three provinces accounted for 82% of the total arrears (FFC presentation to Standing Committee on Appropriations on withholding of LES allocations, 29 July 2015). Initially the number of municipalities affected was 60 but it went down to 59 since 13 May 2015, therefore the number referred to henceforth in this paper will be 59, see www.parliament.gov.za.

¹⁹ Debt in arrears to Eskom amount to R 4.61 billion, while debt in arrears to water boards amount to R 2.2 billion. (FFC 29 July 2015).

²⁰ In total there are currently 278 municipalities: 8 Metropolitan, 44 District and 226 Local municipalities. The total number of municipalities will be reduced to 267 at the local government election in 2016. See the *Local Government Handbook* (2015) 33.

financial intervention in terms of section 216(2) is one of the constitutionally entrenched supervisory mechanisms available to the national government to exert some form of control over all three spheres of government. This measure has thus far only been invoked against municipalities for non-payment of their debts owed to creditors, keeping in mind there is also considerable amount of debt outstanding which is owed to municipalities from other spheres of government and public entities.²¹

2 Autonomy of local government

De Visser (2005) explains that the principle of autonomy is having *final decision-making power* and is critical to ensuring that local government fully exploits its potential to respond to people's needs. He identifies three sub-principles of autonomy; political, administrative and financial autonomy.²²

2.1 Political autonomy

Chapter 7 of the Constitution provides for the local sphere of government which consists of municipalities.²³ The judgment in *Fedsure Life Assurance and Others v Greater Johannesburg Transitional Metropolitan Council and Others*²⁴ serves as the bedrock for the institution of local government as a sphere of government and also to set a precedent for the powers of local government being entrenched in the Constitution.²⁵ The national or provincial spheres of government may not compromise or impede a municipality's ability or right to exercise its powers or perform its functions.²⁶

²¹ National Treasury presentation to the Standing Committee on Appropriations, 13 May 2015.

²² De Visser (2005: 271-273)

²³ S 151 Constitution.

²⁴ 1998 (12) BCLR 1458 (CC) at para 8.

²⁵ The Constitutional Court held that: "Local government is no longer a public body exercising delegated powers. Its council is a deliberative legislative assembly with legislative and executive powers recognised in the Constitution itself." para 26.

²⁶ Kuusi S (2009) 'Aspects of local self-government: South Africa' *North-South Local Government Co-operation Programme, the Association of Finnish Local and Regional Authorities*, p.13.

Local government has constitutionally defined powers and functions which gives rise to its autonomous nature.²⁷ The functions and powers of municipalities include providing water and electricity reticulation to the communities they serve.²⁸

2.2 Financial Autonomy

Financial autonomy is a critical element that “defines whether local government can be seen as an order of government”.²⁹ The financial autonomy of a municipality is derived from its constitutionally entrenched right to raise its own revenue and independent decision-making right on how to spend the revenue it raises. A municipality may raise revenue by imposing rates on property, charging surcharges on fees for services rendered as well as fees for those services.³⁰ However not every municipality raises sufficient revenue from property taxes and service fees.³¹ Larger, urban based metropolitan municipalities enjoy the full benefit of these entrenched revenue powers. The smaller, rural municipality however depends on the intergovernmental transfers it receives from national government in order to remain viable.³²

3 Intergovernmental transfers

While national government raises the vast bulk of aggregate revenues, its expenditure responsibilities are substantially decentralized.³³ The intergovernmental transfers is designed in such a way to provide for the equitable vertical and horizontal division of nationally raised revenue amongst spheres of government in order to make up for fiscal disparities and thereby achieve a fiscal balance.³⁴

Section 214(1) of the Constitution is designed to facilitate the achievement of vertical fiscal balance by providing that each sphere of government receives an equitable portion of total revenue nationally raised. The intergovernmental transfers fall into two categories namely,

²⁷ S 156(1) (a) of the Constitution provides that a municipality has executive authority in respect of, and has the right to administer the local government matters listed in Part B of Schedule 4 and Part B of Schedule 5 of the Constitution and any other matter assigned to it by national or provincial legislation.

²⁸ De Visser, J (2002) ‘Powers of Local Government’ *Local Government Working Paper Series No. 2*.

²⁹ Steytler N (2009) ‘Comparative conclusions’ in Nico Steytler (ed) *Local Government and Metropolitan Regions and Federal Systems* 419.

³⁰ See s 229(1) Constitution, also s 229 (1)(b) prescribes that municipalities may impose other taxes, levies and duties appropriate to local government but only once it has been authorised by national legislation.

³¹ Steytler & De Visser (2012) 12-10

³² *Ibid.*

³³ Chitiga-Mabugu, M and Monkam, N (2013) Department of Economics Working Paper Series NO 76, 3.

³⁴ FFC (2003) *Towards a Review of Intergovernmental Fiscal Relations System* Submission on Medium-Term Expenditure Framework 2004-2007, p.34.

the unconditional grant or Local Government Equitable Share (LES) and the conditional grants.³⁵ For the purposes of this paper only the former will be discussed in detail as it directly relates to section 216.

3.1 The Local Government Equitable Share (LES)

The Constitution requires that an act of Parliament must provide for “the equitable division of revenue raised nationally” among all three spheres³⁶ of government.³⁷ In addition, section 227 (1) (a) provides that local government “is entitled to an equitable share of revenue raised nationally to enable it to provide basic services and perform the functions allocated to it”.³⁸ This means that municipalities have a Constitutional entitlement to its share of nationally raised revenue known as the local government equitable share (LES) and it is not a munificence handed down from national government. Further, the LES is unconditional meaning that municipalities have discretion on how to spend it.³⁹ The nature of the equitable share is apparent when compared to the conditional grants. Further testament that it is an unconditional allocation is the fact that the Division of Revenue Act (DORA)⁴⁰ cannot prescribe conditions for its spending.⁴¹ In section 227(1)(a) the Constitution provides a broad parameter for expenditure; the rationale for the entitlement to the equitable share is “to enable [local government] to provide basic services and perform the functions it is allocated”.⁴²

The LES is calculated using a formula based on the recommendations of the Financial and Fiscal Commission.⁴³ The actual LES amount differs in relation to each municipality as it is calculated by using a formula which is made up of five components:⁴⁴

³⁵ *Ibid.*

³⁶ Refers to local, provincial and national government.

³⁷ S 214(1)(a) Constitution.

³⁸ S 227(1)(a) Constitution.

³⁹ Steytler & De Visser (2012) 11-12.

⁴⁰ Division of Revenue Act 6 of 2011.

⁴¹ Steytler and De Visser (2012) refer to Whelan (2004: 41) “The DPLG has sought to introduce spending content conditions into the equitable grant by sending funding letters to the recipient municipalities, indicating how the equitable share is composed (the so-called funding windows) and how it should be spent, notably on providing free basic services. As Whelan correctly observes, these letters have no formal legal status.”

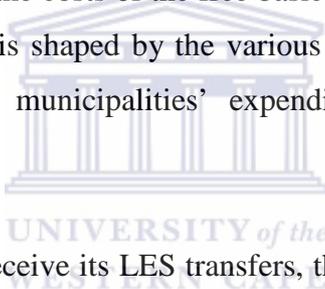
⁴² Steytler & De Visser (2012) 12.

⁴³ S 220-221 Constitution.

⁴⁴ National Treasury (2012) ‘Local Government Equitable Share Formula Review’ LGES Discussion Paper 2- Analysis of the current formula, 10.

- (a) a basic service component to enable municipalities to provide water, sanitation, electricity, refuse removal and other basic services;⁴⁵
- (b) an institutional support component to enable particularly poor municipalities to fund the basic costs of administration and governance;⁴⁶
- (c) a development component which is now dormant;⁴⁷
- (d) a revenue-raising capacity correction;⁴⁸ and
- (e) The correction and stabilisation factor, which makes sure all of the guarantees in the formula can be met and accounts for a negligible proportion of the final equitable share allocations.⁴⁹

The formula for the LES provides a subsidy for the provision of free basic services such as water, electricity, sanitation and refuse removal for every poor household. Therefore, while a municipality does exercise full discretion with regards to how the LES gets spent, it is expected that the LES will cover the costs of the free basic services since it is provided for in the formula. Although the LES is shaped by the various components, the fact that it is an unconditional grant means that municipalities' expenditure is not tied to any of the component parts.⁵⁰



Local government is entitled to receive its LES transfers, the transfers occurs in three cycles, namely on 7 July, 30 November and 23 March of the financial year.⁵¹ The national government cannot manipulate the regular transfer of the LES to which municipalities are entitled. However, because section 216 of the Constitution allows the National Treasury to do exactly that, it is considered an exception.

3.2 Local autonomy and supervision

⁴⁵ The basic services component provides for the cost of free basic services for poor households as well as municipal health services. (National Treasury 2012, 10).

⁴⁶ The institutional support component is worth 7.9 per cent of the value of the equitable share and provides a subsidy for the costs of running a basic municipal administration.

⁴⁷ National Treasury (2012) 10.

⁴⁸ The revenue-raising capacity (RRC) correction accounts for the fact that some municipalities have a much greater ability to raise own revenues than other municipalities and subtracts 7.4 per cent of the value of the equitable share, primarily from the wealthiest municipalities in order to make those funds available for poorer municipalities.

⁴⁹ National Treasury (2012) 10.

⁵⁰ Steytler & De Visser (2012) 11-12.

⁵¹ S 5(3) Division of Revenue Act of 2011.

Supervision and autonomy are countervailing principles; in order to prevent an abuse of power, there are varying degrees of supervision exercised. Local, provincial and national government are in terms of the Constitution, “distinctive, interdependent and interrelated”.⁵² The court held that ‘interrelatedness’ refers to the fact that the three spheres of government are not independent from each other in the exercise of their autonomy.⁵³ The national government supervises provincial government and both national and provincial governments supervise local government.⁵⁴ Intergovernmental supervision is meant to ensure that local government does not abuse the powers entrusted to it.

Supervisory mechanisms available over local government are the financial interventions using either section 139(5) by provincial government or section 216(2) by national government. The two interventions share a common element in that they both entail intervening in a municipality when there is a crisis in its financial affairs and both prescribe intervening when a municipality is in “serious or persistent material breach”⁵⁵ of its obligations. The MFMA has added further supervisory duties in respect of financial management, which are, however, distinctly subject to that of the national government.⁵⁶ Given the significance of local government expenditure, the prudent use of its financial resources is imperative.⁵⁷ One of the constitutional objects of local government is “to ensure the provision of services to communities in a sustainable manner.”⁵⁸

3.3 Interventions addressing local financial crises

Section 216(2) is not the only measure used to address local government financial crises, more important is section 139(5) of the Constitution. The intervention by the provincial government into local government finances will be briefly addressed.

3.3.1 Section 139(5) intervention by province into a municipality

Section 139 in general presents a number of mechanisms that a province may use to remedy failures of a municipality. Section 139(5) in particular, applies when a municipality is experiencing a financial crisis and as a result of this, is in “serious or persistent material

⁵² S 40(1) Constitution.

⁵³ *Independent Electoral Commission v Langeberg Municipality* 2001 (9) BCLR 883 (CC) at para. 26.

⁵⁴ Steytler & De Visser (2012) 15-5.

⁵⁵ Analysis of the terms given in the substantive requirements of s 216(2) under the legal framework.

⁵⁶ Steytler & De Visser (2012) 15- 7 to 15-8.

⁵⁷ Steytler & De Visser (2012) 15-5.

⁵⁸ S 152(1) (b) Constitution.

breach” of its obligations to provide basic services or meet its financial commitments. The remedy section 139(5) offers, is to impose a financial recovery plan in accordance with national legislation to meet its financial commitments. This, the municipality must implement or have its municipal council dissolved and be placed under administration. As a creditor of a municipality under section 139(5); who is running the risk of bankruptcy as a consequence of the staggering debt owed to it; it would have to wait until the process of section 139(5) financial recovery plan takes its course before being repaid.

3.3.2 Financial intervention by the National Treasury

While the provincial supervisory role is based on its general oversight responsibility, the National Treasury’s oversight function over local government is confined to financial management.⁵⁹ In coordinating the intergovernmental fiscal framework, National Treasury creates fiscal norms and standards. It also plays a significant supervisory role over all three spheres of government in ensuring that they comply with the regulations within the fiscal framework, it can do so by means of withholding funds from a sphere of government by invoking section 216(2) of the Constitution.⁶⁰

4 Legal framework for invoking section 216

Section 216 of the Constitution sets out both the substantive and the procedural requirements for the drastic intervention measure of stopping the LES transfers to municipalities.

4.1 Substantive requirements of section 216

4.1.1. Norms and standards of section 216(1)

Section 216(1) of the Constitution mandates that national legislation prescribe measures to ensure both transparency and expenditure control in each sphere of government and establishes the National Treasury to enforce compliance with these measures. All three spheres of government are obliged to comply with the measures under section 216(1).

(a) *Generally recognised accounting practices*

⁵⁹ Steytler & De Visser (2012) 15-8.

⁶⁰ S 6(2) (f) Public Finance Management Act 1 of 1999.

This refers to an accounting practice complying in material respects with standards issued by the Accounting Standards Board.⁶¹ The Public Finance Management Act (PFMA) provides for the role and duties of the Board,⁶² of which the main duty is to set standards of generally recognised accounting practice as required by section 216(1)(a) for the annual financial statements of national or provincial government institutions; Parliament or provincial legislatures; constitutional institutions; municipal board, commission, company, corporation, fund or other entity under the ownership control of a municipality.

(b) *Uniform expenditure classifications*

There is currently no uniform expenditure classification system in place for local government. National Treasury is in the process of finalising a ‘standard chart of accounts’ (SCOA)⁶³ for local government as part of its legislative task to determine a uniform expenditure classification.⁶⁴ The awaited SCOA is said to include that core services such as electricity and water be ring-fenced.

(c) *Uniform treasury norms and standards*

National Treasury as part of national government must regulate municipal competencies but only within the framework of respect for municipal autonomy, support and oversight. The Constitutional Court has remarked that these framework powers permit national and provincial governments to create “norms and guidelines for the exercise of a power or the performance of a function.”⁶⁵ The analysis of section 216(1)(c) is key to determining whether the non-payment of municipalities to their creditors, 30 days after invoices were sent to the municipalities in question, falls within the norms and standards of National Treasury, the grounds upon which section 216(2) was invoked by National Treasury in March 2015. It is

⁶¹ Chapter (PFMA).

⁶² Ss 88— 91 PFMA.

⁶³ The SCOA is a detailed financial classification system incorporating government financial statistics (GFS), economic reporting framework (ERF), generally recognised accounting practice standards (GRAP standards) and the Municipal Budget and Reporting Regulations.

⁶⁴ This project was commissioned by the Technical Committee on Finance (TCF) and has been in process since January 2010 of which, as part of the process, included extensive consultation with a wide audience including all municipalities between August and October 2012. The engagements were structured to provide a detailed understanding of the classification framework (SCOA) including the project summary document. In Parliament it was submitted that the new SCOA project would include that core services be ring-fenced and full implementation is envisaged for 1 July 2016. In this regard, municipalities will be required to compile their 2016/17 budgets and MTREF’s SCOA compliant during the 2015/16 financial year.

(See National Treasury MFMA Circular No. 66 Municipal Budget Circular for the 2013/14 MTREF p. 8-9).

⁶⁵ *Minister of Local Government, Environmental Affairs and Development Planning, Western Cape v The Habitat Council and Others; Minister of Local Government, Environmental Affairs and Development Planning, Western Cape v City of Cape Town and Others* 2014 (5) BCLR 591 (CC) at par. 22.

evident from the analysis above that it does not fall within the other two sub-categories of section 216(1).

The meaning of a ‘norm’ and ‘standard’ finds application here for a better interpretation of this substantive requirement. Accordingly, *Collins Dictionary of Law*⁶⁶ defines a ‘norm’ as something that *ought* to happen in the manner provided. This would suggest that a norm is a guiding principle or policy as opposed to a ‘rule’ that is defined as a point of law settled by authority.⁶⁷ *Black’s Law Dictionary*⁶⁸ defines a ‘standard’ as a generally recognised established practice that can be used as a model.

The sources which make up the ‘National Treasury norms and standards’ for municipalities has been listed in the Treasury’s Circular⁶⁹ pertaining to the MFMA. Other sources making up the norms and standards are regulations, circulars, and guidelines; with the result that the norms and standards of NT are very broad.

For the purposes of this paper in dealing with the interpretation of payment to creditors within 30 days, only the statutory guidelines under the MFMA find application. The MFMA lists the objective of NT, to secure “sound and sustainable management of the fiscal and financial affairs of municipalities” through the establishment of norms and standards thereby ensuring transparency, accountability and appropriate lines of responsibility in the fiscal and financial affairs of municipalities.⁷⁰ These responsibilities must be executed within the framework of co-operative government as set out in Chapter 3 of the Constitution⁷¹ and the legislation dealing with the intergovernmental fiscal relations between entities.⁷²

The coupling of the concepts of the ‘institution’ and ‘the norms and standards’ indicates that National Treasury’s task is to formulate and enforce these norms.⁷³ This is made clear in section 216(2), which provides that the National Treasury must enforce compliance with the

⁶⁶ *Collins Dictionary of Law*, 2ed (2001).

⁶⁷ *The Law Student’s Dictionary* (2008).

⁶⁸ *Black’s Law Dictionary*, 10ed (2009).

⁶⁹ National Treasury MFMA Circular No. 66 Municipal Budget Circular for the 2013/14 MTREF, 8.

⁷⁰ S 2(a) MFMA.

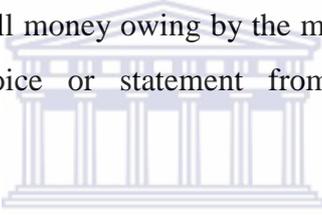
⁷¹ Chapter 3 of the Constitution not only establishes three spheres of government; national, provincial and local; it also entrenches cooperative governance within the three spheres. This includes, amongst other things to provide effective, transparent, accountable and coherent government for the Republic as a whole (see s. 41). Steytler & De Visser (2012) 16-4.

⁷² S 5(1) (b) MFMA.

⁷³ Steytler & De Visser (2012) 15-7.

measures established in terms of section 216(1) of the Constitution. Section (5)(1)(c) of the MFMA also provides that Treasury must enforce compliance with the “measures established in terms of section 216(1) of the Constitution”.

4.1.2 Is the statutory guideline on ‘payment to creditors within 30 days’ as provided for under the MFMA, a norm or standard in terms of section 216?

The MFMA includes a provision dealing directly with the non-payment by municipalities to their creditors within 30 days in terms of section 65(2)(e). Since the MFMA is a listed source under NT norms and standards, section 65(2)(e) does amount to a norm of standard which is equivalent to a guideline as opposed to a rule as discussed above. Further proof of section 65(2)(e) being a norm/guideline is that the section explains that the municipal manager need only *try* to pay its creditor within 30 days after receiving the invoice for payment. In terms of section 65(2)(e) of the MFMA, the accounting officer of a municipality must take all *reasonable* steps to ensure “that all money owing by the municipality be paid within 30 days of receiving the relevant invoice or statement from a creditor, unless prescribed otherwise...”. 

There are two important implications that arise from this guideline in the MFMA. The first being that payment to a creditor within 30 days is still very broad in the sense that the MFMA does not specify a *particular* creditor that needs to be prioritised for payment - either in relation to the significance a creditor may have in relation to the type of service it provides the municipality with or in any other way.

Secondly, the section provides that the accounting officer should take all *reasonable* steps to make payment to creditors within 30 days; as to what constitutes ‘reasonable’ is usually interpreted by a court in the context of relevant factors. The same will apply in relation to section 65(2)(h) of the MFMA which provides that the accounting officer (municipal manager) of a municipality must take all *reasonable* steps to ensure that the “municipality’s available working capital is managed effectively and economically”.

Therefore, in answer to the question of whether ‘payment to creditors within 30 days’ as provided for under the MFMA is a norm of standard in terms of section 216, the answer is yes; reasonable steps to pay within 30 days is a norm of standard under National Treasury.

Therefore, if no reasonable steps have been taken by the municipality to pay its creditors within the 30 day period, there is a breach of the norm of standard.

4.2 Financial intervention in terms of section 216(2)

Section 216(2) provides that:

The national treasury must enforce compliance with the measures established in terms of subsection (1), and may stop the transfer of funds to an organ of state if that organ of state commits a serious or persistent material breach of those measures.

Each of the elements presented in section 216(2), will be analysed to interpret exactly when National Treasury can intervene in a sphere of government. The Constitution states that NT *may* do so only if an organ of state commits a “serious” or “persistent”, “material breach” of the measures listed in subsection (1) as discussed above.

4.2.1 Discretion exercised by the National Treasury

In section 216(2), the word “may” affords the National Treasury with a choice to either invoke the financial intervention or not. Before exercising its discretion, NT *must* consider all the relevant factors as provided for under the MFMA⁷⁴ specifically when the LES is stopped.⁷⁵

The relevant facts which must be taken into consideration are the following:

First, the municipality’s compliance with, in particular the annual financial statements, including submitting its annual financial statements to the Auditor-General.⁷⁶ Secondly, the municipality’s compliance with its budgets, which includes submitting information on the budget and implementation of the budget to the National Treasury and the relevant provincial treasury.⁷⁷ The last factor is the municipality's co-operation with other municipalities on fiscal and financial matters; in the case of district and local municipalities.⁷⁸

⁷⁴ S 38(4) (a-b) MFMA.

⁷⁵ S 38 (4) MFMA.

⁷⁶ S 38(4) (a) (i) MFMA.

⁷⁷ S 38(4) (a) (ii) MFMA.

⁷⁸ S 38(4) (a) (b) MFMA.

In relation to the intervention itself, the PFMA provides in terms of section 6(2)(f) that one of Treasury's functions is that it must intervene to address a "serious or persistent material breach" of this Act by a department, public entity or constitutional institution, by taking appropriate steps which *may* include withholding of funds in terms of section 216(2) of the Constitution. Similarly, section 5(2)(e) of the MFMA⁷⁹ confers general enforcement mechanisms on the National Treasury by providing that it may stop the transfer in terms of section 216(2) if a municipality commits a "serious or persistent material breach" of the Act. The MFMA, also contains a provision mirroring section 216(2) except that it relates specifically to a municipality; section 38(1)(a) of the MFMA provides that National Treasury may stop the equitable share transfer (referred to in section 214(1)(a) of the Constitution). Once again, it states that the grounds for invoking such an intervention must be the result of an organ of state (in this instance a municipality) committing a "serious or persistent breach" of the measures established in terms of section 216(1) of the Constitution.⁸⁰

It is submitted that in order to give effect to a proper interpretation of when an intervention becomes applicable under section 216(2) and the other statutory provisions, it is necessary to give interpretation of the ordinary meaning of the words "serious", "persistent", "material", "breach" since they are key to assessing when the actions of an organ of state amount to non-compliance of obligation under section 216(1).

Before looking at the meaning of these words in order to gain a better interpretation of them it is important to understand the context in which they are placed. The words "serious", "persistent" and "material" all relate to the act of a "breach". In the given context, there is a duty on an organ of state to comply with the measures set out by National Treasury in terms of section 216(1)(a)—(c) and if an organ of state fails to comply with the norms and standards set by NT, it amounts to a breach of those norms and standards.

First, the breach must be "material", meaning that the nature of the breach must relate to essential parts of the prescribed obligations on an organ of state.⁸¹ In essence, the manner in which an organ of state fails to meet the substantive requirements under section 216(1) (a)—

⁷⁹ S 5(2) (e) MFMA.

⁸⁰ S 38(1) (a) MFMA.

⁸¹ Oxford English dictionary for Students (2006) Oxford University Press.

(c) is important because the words “serious” and “persistent” qualify the materiality of the breach.

Secondly, to determine if an action committed by an organ of state is “serious”, the action itself needs to be substantial in size, number or quality.⁸² A trivial breach of a material element of the norm is not sufficient.

Thirdly, for the action committed by an organ of state to be “persistent” it means that the conduct must occur continuously over a period of time.⁸³ In contrast, to “serious”, the breach in this instance becomes serious because of its repetitive nature.

Section 216(2) therefore finds application when the breach is material, the breach is either serious (in size, quality or quantity) or occurs routinely over a period of time (persistently). In many cases both elements may be present – a serious breach which occur on a regular basis.

4.3 Procedural requirements for invoking section 216(2)

The procedural requirements to be followed when withholding the LES transfer in terms of section 216(2) are provided for in section 216(3)-(5) of the Constitution. These procedural requirements deal exclusively with the withholding of the equitable share transfer from a province. The MFMA,⁸⁴ however, gives procedural guidance for withholding the LES transfer from a municipality. The procedural steps contained in the MFMA, mirror the procedural steps prescribed in the Constitution for the withholding of the equitable share from a province.

4.3.1 Procedure for stopping Provincial Equitable Share (PES) transfers

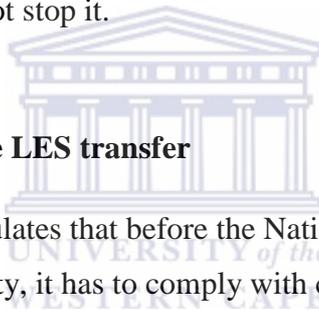
The procedural requirements to be followed by National Treasury when withholding a transfer from a province, is set out under section 216(3) of the Constitution. National treasury is authorised to enforce section 216(2) immediately but must seek the approval of Parliament 30 days after the decision is made, failing which, the decision will lapse retrospectively. The

⁸² *Ibid.*

⁸³ *Ibid.*

⁸⁴ S 38 MFMA.

approval process prescribed for Parliament to follow should comply with section 76(1) of the Constitution, which is the same for when an ordinary bill affecting provinces is passed in Parliament.⁸⁵ Where a section 76 bill is introduced in the NCOP or after it has been approved by the National Assembly, section 65 applies, which requires that the provincial legislatures must deliberate on the bill and provide their delegations to the NCOP with a mandate on how to vote. A bill is passed by the NCOP if five of the nine provincial delegations vote in favour thereof. If there is disagreement between the two Houses (National Assembly and NCOP), the bill must go to the Mediation Committee.⁸⁶ If the Mediation Committee cannot reach agreement within 30 days of the bill being referred to it then the bill lapses or “dies” unless the National Assembly again passes the Bill, but with a supporting vote of at least two thirds of its members.⁸⁷ The impact of this is that the NCOP has a strong authority over passing a bill in terms of section 76. In contrast, where a bill does not deal with a provincial matter (section 75 bill), the provincial delegates vote in their own capacity; a negative vote can only delay the passing of the bill but not stop it.



4.3.2 Procedure for stopping the LES transfer

Section 38 (2) of the MFMA stipulates that before the National Treasury stops the transfer of an equitable share to a municipality, it has to comply with certain mandatory procedural requirements which entails *prior* consultation with the relevant municipalities.⁸⁸ Steytler and De Visser⁸⁹ submit that the envisaged prior consultation should ensure that the exercise of a sphere’s autonomous powers (such as supervision) is done with the full knowledge of the interests of all concerned and not only with the narrow interests of the actor in mind. By making consultation mandatory it means that it is a validity requirement for the legislation in question.⁹⁰

4.3.2.1 Consultation with affected municipalities

Consultation has been defined in terms of the Intergovernmental Relations Framework Act, 13 of 2005 (IGRFA) as “a process whereby the views of another on a specific matter are

⁸⁵ S 76 (1) Constitution.

⁸⁶ S 76 (1) (d) Constitution.

⁸⁷ S 76 (1) (e) Constitution.

⁸⁸ S 38 MFMA is found in Chapter 5 ‘Co-operative government’.

⁸⁹ Steytler & De Visser (2012) 16-13.

⁹⁰ *Robertson v City of Cape Town* 2004 (9) BLCR 950 (C) at para 75-76.

solicited, either orally or in writing, and considered.”⁹¹ The courts have held that there is no prescription on the form of consultation, so long as the ‘lines of communication are open’ and the parties are afforded ‘reasonable opportunity to put their cases/ points of view to one another’.⁹² Where consultation is a legislative requirement, the process should be more formal and the process should be well-documented in writing.⁹³

The basic elements of consultation can be summarised as follows:⁹⁴

- (a) there must be an invitation⁹⁵ to hear the views of a particular party (or public in general) on a specified matter;
- (b) there is an adequate opportunity to the invitee to furnish considered views; and
- (c) there is consideration of those views in good faith.

The MFMA prescribes that the National Treasury must give the municipality an opportunity to submit written representations with regard to the proposed stopping of the funds.⁹⁶ This is in line with the first requirement of consultation which is the invitation requirement to hear the views of the other party concerned.⁹⁷ The National Treasury should ensure this invitation is done formally as it is a legislative requirement. It is submitted that the following steps should be followed as listed above:

1. The National Treasury must give notice to the affected municipality, namely that it is considering stopping the LES transfer and it should give reasons as to why;
2. The affected municipality should be given an adequate opportunity to respond to this notice of the National Treasury; and
3. The National Treasury should consider the municipality’s response in good faith.

⁹¹ S 1(1) “consultation” in IGR Framework Act.

⁹² *Hayes and Another v Minister of Housing, Planning and Administration, Western Cape and Others* 1999 (4) SA 1229 (C) at 1242J–1243A.

⁹³ *Robertson v City of Cape Town* at para 109.

⁹⁴ Steytler & De Visser (2012) 16-13.

⁹⁵ Steytler and De Visser ((2012) 16-13) explain that the invitation to hear the views of other parties can take one of two forms which is either passive or active. In its passive form, the consulting party extends a general invitation to interested party/public, setting a closing date for responses, leaving it to the addressees whether or not to respond. The more active approach is to solicit the views of particular parties and ensure that their views are indeed obtained.

⁹⁶ S 38(2) (a) MFMA.

⁹⁷ Also reflected in the *audi alteram partem* rule ‘to listen to the other side’.

The impact of Treasury not fulfilling consultation with the affected municipalities as prescribed in terms of the procedural requirements before stopping the LES transfers, amounts to an invalid act.⁹⁸

4.3.2.2 Consultation with CoGTA

The National Treasury is required to consult with the Cabinet member responsible for the national department making the transfer.⁹⁹ This procedural step is not applicable in the case of the LES as it is the Treasury who is making the transfer. It may be relevant in cases of conditional grants transferred by line departments.

4.3.2.3 Notification

The third required procedural step under the MFMA, is for Treasury to inform the MEC for local government in the province before the decision is taken.¹⁰⁰ It is then the responsibility of the province to monitor and support a municipality within its provincial jurisdiction. In terms of the MFMA,¹⁰¹ if the stopping of funds affects the provision of basic municipal services in the municipality, the provincial executive must monitor the continuation of those services. Section 139 of the Constitution applies if the municipality cannot or does not fulfil its obligations with regard to the provision of those services.

Should the National Treasury *not* inform the MEC of local government, it is submitted that this would not amount to an invalidity of the intervention. As it is merely a notification duty, and not a consultation duty as explicitly required with regard the affected municipalities and line departments making transfers, it should not affect the decision itself. It is a mere informational duty to alert the MECs that they must monitor possible negative consequences of the stopping of the transfers. It is thus submitted that failure to inform them is not essential for the validity of Treasury's decision.

4.3.2.4 Post-stoppage review

⁹⁸ *Robertson v City of Cape Town* at para 75-76.

⁹⁹ S 38(2) (c) MFMA.

¹⁰⁰ S 38(2) (b) MFMA.

¹⁰¹ S 38(3) MFMA.

Similarly to the section 216(2), section 39(1) (b) in the MFMA provides the decision taken by Treasury may be enforced immediately, but there is an approval process after the event. Parliament needs to approve Treasury's decision to withhold the transfer following a process substantially the same as that established in terms of section 75 of the Constitution, which is the process for passing a bill *not* affecting provinces. This process must be completed within 30 days of the decision being made, failing which, the decision will also lapse retrospectively.

Section 75 of the Constitution, as outlined above, requires that Treasury's action must be approved by both the National Assembly and the NCOP. In this instance, section 65 does not find application (as it does with section 76) meaning each representative of the NCOP votes in their individual capacity and not according to their respective province. This means that provincial influence is very limited as opposed to the section 76 procedure, where the provinces have real influence through their participation. Each provincial delegate has one vote and passing the legislation is determined by the majority of votes of which there should be at least a third of the delegates to form a quorum.¹⁰² In terms of section 75, it is easy for the NA to override if the NCOP disapproves; only a simple majority in the NA is required

The Constitution provides for the participation of organised local government (SALGA) in legislative processes by granting it limited membership of the National Council of Provinces (NCOP), however SALGA cannot vote in these discussions. Of course, the NCOP will give considerable attention if the matter deals with local government matters.

Once the approval process by Parliament of Treasury's decision to withhold funds is completed the equitable share transfer may not be stopped for more than 120 days but Parliament may renew a decision to stop the transfer of funds for no more than 120 days at a time, following the same Parliamentary process as prescribed in terms of section 75 for municipalities¹⁰³ Before Parliament approves or renews a decision to stop the transfer of funds mentioned above, it may request the Auditor-General to report to it, and must give an

¹⁰² S 75 (2) Constitution.

¹⁰³ S 216(3) (a) and s 216(4) of the Constitution dealing with provinces are reflected in the wording of s 39(2) of MFMA.

opportunity to the affected province/ municipality to answer allegations against it, and to state its case, before a Parliamentary committee.¹⁰⁴

Aside from the mandated procedural steps, the NA and the NCOP also have a constitutional duty to include public participation when executing their legislative and other decision-making processes.¹⁰⁵ This is necessary as it is important for the municipality to be heard and for the residents of a municipality to be heard. In order to enable that this consultative process deals with the specific matter of withholding the LES transfer of defaulting municipalities, a specific invitation should be given to the relevant municipality and its residents.

5 Conclusion

The main aim of this chapter has been to expand and give clarity on the substantive and procedural requirements for the invocation of section 216(2) financial intervention by the National Treasury against specifically municipalities for non-payment of its two main creditors. This is the summary of the substantive requirements for invoking section 216(2) against defaulting municipalities:

The non-payment to creditors within 30 days needs to be a substantial ground listed in terms of section 216 (1) (a)—(c) before invoking section 216(2) of the Constitution. ‘Taking reasonable steps to pay creditors within 30 days’ falls under section 216(1) (c) of Treasury’s norms and standards as articulated in the MFMA¹⁰⁶.

The fact that there is debt being owed over the 30 days would suggest that no reasonable steps have been taken by the defaulting municipality.

In terms of section 216(2) there must be a material breach of this payment norm; if the non-payment is over 30 days but the materiality is qualified by the seriousness (substantial amount of the debt owed) or the persistence (debt has occurred periodically over time) of the non-payment.

¹⁰⁴ S 216(5) of the Constitution dealing with provinces is reflected in the wording in s 39(3) of MFMA.

¹⁰⁵ Ss 59(1) (a), 72(1) (a) and 118(1) (a) Constitution.

¹⁰⁶ The MFMA is an established source of Treasury norms and standards.

The procedural requirements apply to the National Treasury are as follows:

Treasury must engage in consultation with the relevant municipalities prior to withholding the LES transfer in terms of the MFMA¹⁰⁷ and the Constitution.¹⁰⁸ The consultation must begin with an invitation to hear the views of the affected party on a specified matter. There must be adequate opportunity for the affected party to furnish considered views, and Treasury must give consideration of those views in good faith. These are the requirements for valid consultation to occur and failure to do so thus affects the validity of Treasury's decision. Treasury also needs to inform the MEC for local government of its decision to withhold the LES transfer; however, non-compliance with this duty does not affect the validity of the decision.

Once the decision has been taken, Parliament must approve of the stoppage in terms of the following procedure: Parliament, NA and NCOP, sitting separately, need to approve the decision taken by Treasury to withhold the transfer within 30 days of it being made. The process to be followed is that of passing a bill in terms of section 75 of the Constitution.

There is a duty on the NA and NCOP to facilitate public participation in their legislative process, including section 73 process which precedes section 75 in deliberating over Treasury's decision.

Parliament may renew the decision to withhold the transfer but not for longer than 120 days at a time.

Using the above summarised points of substantive and procedural required steps, the next chapter assesses whether Treasury's decision to stop the transfer of the equitable share to 59 municipalities was lawful. The events that have taken place since the equitable share was withheld on the 20th of March 2015 will be assessed in terms of the legal framework which has been laid out in this chapter in order to test the legality of Treasury's decision.

¹⁰⁷ S 38(2) MFMA.

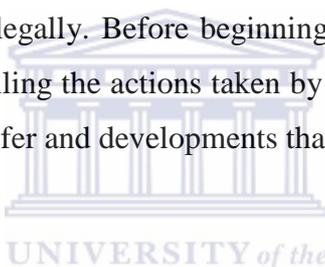
¹⁰⁸ S 41(1) (h) (iii) Constitution.

Chapter 3

Application of the legal framework for section 216 to the facts

1 Introduction

The National Treasury is constitutionally empowered to invoke the financial intervention of stopping the equitable share transfer to any sphere of government in terms of section 216 of the Constitution to remedy non-compliance with section 216 (1). The financial intervention has substantive and procedural requirements which must be met in order to be constitutionally valid. This chapter assesses the actions of the National Treasury against the substantive and procedural requirements of the Constitution, as they have been laid out in chapter 2, in order to determine whether the intervention invoked against municipalities by the National Treasury was done legally. Before beginning with the assessment, the facts of the intervention are laid out, detailing the actions taken by National Treasury and Parliament regarding withholding of the transfer and developments that have occurred since then.



2 Stopping of transfers to 59 municipalities in March 2015

It became apparent during the course of 2014 that Eskom had reached a state of financial crisis, and the moneys owed to Eskom, especially that owed by municipalities in arrears needed to be paid to alleviate this crisis. If Eskom did not receive what was owed to it then it would turn bankrupt, and this would in effect jeopardize the economy of the country.¹⁰⁹

On Friday 6 March 2015, National Treasury issued a notice via e-mail to 59 municipalities at approximately 6.47 pm, informing these municipalities that if they did not settle their debt in arrears owed to the creditors Eskom and the water boards by 13 March 2015, their equitable share would be withheld.¹¹⁰ The actions of the National Treasury came soon after an incident between Eskom and Matjhabeng Local Municipality unfolded in court on 19 February 2015, involving the failure of the local municipality to honour its payment agreement with

¹⁰⁹ National Treasury presentation to Standing Committee on Appropriations (13 May 2015).

¹¹⁰ SALGA presentation 'Withholding of equitable share to municipalities' *Portfolio Committee meeting on Cooperative Governance and Traditional Affairs* (12 May 2015).

Eskom.¹¹¹ Matjhabeng Local Municipality was also one of the 59 municipalities whose LES transfer has been withheld.

On 20 March 2015, Treasury implemented its decision to withhold the transfer of the LES to the 59 municipalities in terms of section 216(2). Treasury cited that the reason it was withholding the transfer from these specific municipalities was due to their “failure to honour their financial commitments in general and to pay Eskom and other service delivery creditors in line with section 65 (2) of the Municipal Finance Management Act, 2003...” Further, that the “persistent failure by some municipalities to pay creditors within 30 days” was the reason it saw fit to invoke the financial intervention of section 216 (2) against the 59 municipalities.¹¹² With regards to the specificity of the amount of debt owed in arrears, Treasury stated that the municipalities, as at 31 December 2014, owed Eskom R9 billion of which R4.5 billion was debt in arrears (debt that was more than three months old), and municipalities owed water boards R3.6 billion, of which R2.3 billion was in arrears.¹¹³ Treasury explained that the failure of municipalities to settle their Eskom payments within 30 days, negatively impacted on Eskom’s cash flow thereby compromising the utility’s operations and financial position. While its decision would affect municipalities’ ability to meet its financial obligations, it could no longer condone financial mismanagement.¹¹⁴ Thus Treasury set the condition that the LES transfers would only be released once all the requirements as communicated to municipalities were met, of which a formal repayment arrangement between the parties was required.¹¹⁵ By 29 April 2015, 50 percent of the 59 defaulting municipalities had reached payment agreements terms with Eskom in order to have their equitable share released.¹¹⁶

On 12 May 2015, Jan Hattingh (Chief Director of Local Government Budget Analysis, National Treasury) outlined to the National Assembly Treasury’s reasons for withholding the equitable share from municipalities. They were, to address the growing culture of non-payment as evidenced in financial reports showing debt increasing annually to levels higher

¹¹¹ *Matjhabeng Local Municipality v Eskom Holdings Soc Ltd and Others* (924/2013) [2015] ZAFSHC 30.

¹¹² Citizen News ‘SA Treasury stops funding to municipalities who owe Eskom’ (31 March 2015).

¹¹³ *Ibid.*

¹¹⁴ *Ibid.*

¹¹⁵ *Ibid.*

¹¹⁶ “Municipalities hear Eskom's threat and pay up” (29 May 2015) available at <http://www.fin24.com/> (accessed 14/7/15).

than the budgets of some municipalities.¹¹⁷ He also pointed out that the outstanding debt to Eskom and Water boards were not prioritised for payment, indicating that the equitable share was not being used to pay for services.¹¹⁸ It was the duty of National Treasury to ensure that the economy of the country is safe guarded and the debt crisis against Eskom put the country's only electricity supplier in a vulnerable position and also put the country's economy at risk should Eskom have turned bankrupt.

The Minister of Cooperative Governance and Traditional Affairs at the time, Pravin Gordhan, released a statement that the Finance Minister at the time, Nhlanhla Nene did not notify him of the intervention and as a result he was only notified after the decision had already been made by National Treasury to withhold the LES.¹¹⁹ The Department of Cooperative Government and Traditional Affairs (CoGTA) and the National Treasury did not meet before the LES was withheld and in the Portfolio Committee in Parliament on 12 May 2015 it was submitted by SALGA that as a result of this lack of consultation between the two, political principals were not briefed, which resulted in Treasury withholding funds from municipalities that were not supposed to be affected by the intervention.¹²⁰ Seeing that these municipalities did not in the first place have powers and functions to reticulate water and electricity, they should not have been held responsible for the non-payment to the creditors. Treasury's response to the Portfolio Committee was that the intervention was aimed at addressing a number of financial management contraventions over and above municipalities' inability to pay creditors.¹²¹ Minister Gordhan did warn, however, after viewing financial reports against mayors and officials who had been reported to have bought new cars valued in the region of R1-million in their final year of office that "this nonsense had to stop".¹²²

Treasury said that the defaulting municipalities were informed of the decision to withhold the grants in early March, and were given a 13 March deadline to settle outstanding debt. At the same time SALGA criticised the deadline given to municipalities as being too short and

¹¹⁷ CoGTA, briefing to Portfolio Committee on Appropriations on the reasons for withholding equitable share allocations from municipalities, 12 May 2015 available at <https://pmg.org.za/committee-meeting/20884/> (accessed 01/06/2015).

¹¹⁸ *Ibid.*

¹¹⁹ Ferreira E "SALGA declares dispute with Treasury over Eskom debt" *Mail & Guardian* 14 May 2015.

¹²⁰ SALGA presentation 'Withholding of equitable share to municipalities' Portfolio Committee meeting on Cooperative Governance and Traditional Affairs, 12 May 2015.

¹²¹ Briefing by Minister to Portfolio Committee 'Reasons for withholding the equitable share from municipalities' (Department of Cooperative government & Traditional Affairs) 12 May 2015.

¹²² Capazorio B 'Stop your nonsense now' *Sunday Times* 15 May 2015.

initiated an intergovernmental dispute with Treasury on 14 May 2015 questioning the appropriateness of Treasury's decision, saying "the manner in which this is being handled, it is making it difficult for service delivery." Eskom also received criticism for its 15-day payment deadline from SALGA, which is seen as an unfair exception that is designed to ease the utility's cash flow but puts more pressure on municipalities as it hikes up their interest payments, particularly on arrears. Thabo Manyoni, the chairperson of SALGA, submitted that "the interest rate when payment was not done, of prime plus 5%, was what was keeping municipalities indebted".¹²³ SALGA submitted in Parliament that it was willing to assist municipalities having trouble in paying but the manner in which the withholding of equitable share was being done was antagonistic toward the municipalities.¹²⁴

The FFC also submitted information pertaining to the defaulting municipalities, showing that the major debtors in arrears to Eskom were municipalities in Mpumalanga, Free State and the North West which accounted for 82 percent of total arrears owed to Eskom. It is evidently based on the location of these municipalities affected by the stoppage, that because they are located in smaller rural areas they inevitably struggle to raise their own revenue in comparison to larger, metropolitan municipalities. The concern with this is that these particular municipalities need their equitable share to remain viable and to provide free basic services to the poor households in their areas.¹²⁵

On 29 July 2015, the NA's Standing Committee on Appropriations held a meeting¹²⁶ on the issue of the stoppage of the equitable share and in the meeting the recent developments since the stoppage had been enforced was submitted by the National Treasury. The Treasury had released a total of R1.8billion to municipalities since 47 out of 51 municipalities owing Eskom alone had signed payment agreements with Eskom and 11 municipalities out of 14 owing water boards had signed payment agreements with the Water Boards.

On the required consultation, Hattingh, on behalf of the Treasury, said that the process of communicating with the municipalities on the issue of debts being owed had started in 2009/10 and that a record of the communications had been presented to the Parliamentary

¹²³ See minutes of National Treasury presentation to Standing Committee on Appropriations, 13 May 2015.

¹²⁴ National Treasury presentation to Standing Committee on Appropriations, 13 May 2015.

¹²⁵ The FFC submitted to the Standing Committee on Appropriations (13 May 2015) that on average the LES accounted for between 31% and 37% of the operating revenue of the affected municipalities, with Mopani district municipality reaching 97% of its operating revenue.

¹²⁶ Minutes of Standing Committee on Appropriations on withholding of LES allocations, 29 July 2015.

Committees.¹²⁷ It was further submitted by Hattingh that upon receiving the records of meetings from Treasury, “it was very clear that the Committees wanted Treasury to do ‘something’” and that “when this had been presented to the Presidential Infrastructure Coordination Commission (PICC), both the President and the Deputy President had made it very clear to Ministers to get their houses in order.”¹²⁸ It was maintained by Hattingh that Treasury did consult with *all* the affected municipalities and that Treasury had kept records of all interactions generated under section 41 of the PFMA.

The Minister of Home Affairs, Malusi Gigaba (acting on behalf of the Minister of Finance), led a briefing on 27 September 2015 on the equitable share release which announced that 54 out of the 59 defaulting municipalities had now received their full portion of the equitable share while 3 had received part of their equitable share. The remaining two, Renosterberg and Ngwathe local municipalities, had still not received any funds.¹²⁹

While the main issue is over the debts owed and accumulated by the defaulting municipalities, the debts owed to municipalities by provincial and national departments as well as private businesses remain a cause of concern. According to Tozi Faba (Deputy Director General, CoGTA), national departments owe 278 municipalities about R4.8billion. He further said: “there is no particular reason that one can give [for not paying] except to say here and there departments are just defaulting and from time to time they will query the amounts”.¹³⁰ Even though it has been reported by Treasury that the amount owed to municipalities by national government departments (R4.8billion) is small in comparison to R104 billion owed by private households and businesses. On 27 October 2015, the Deputy Director-General for Intergovernmental Relations at the Treasury, Malijeng Ngqaleni revealed that 27 out of the 59 defaulting municipalities who had signed payment agreements with Eskom were not honouring those agreements. This prompted SALGA to hold emergency talks with the 27 defaulting municipalities.¹³¹ Ngqaleni said they were concerned that municipalities defaulted despite making arrangements to pay Eskom that were affordable

¹²⁷ See minutes of Standing Committee meeting on Appropriations, 29 July 2015.

¹²⁸ *Ibid.*

¹²⁹ Donnelly L ‘National departments owe municipalities R4.8bn’ *Mail & Guardian* 27 September 2015, available at <http://mg.co.za/> (accessed 8/12/15).

¹³⁰ *Ibid.*

¹³¹ Mkhwanazi S ‘Eskom is owed R9bn: Treasury acts’ (27 October 2015) article available at <http://www.iol.co.za/> (accessed 18/11/15).

for the municipalities in question.¹³² This led to the Treasury writing letters to the 27 municipalities a week earlier 20 October 2015, warning them that transfers would be stopped unless they paid Eskom what was due to them.¹³³

Treasury told Parliament in the week preceding 27 October 2015, that Treasury would invoke section 216(2) and withdraw funding to these 27 municipalities.¹³⁴ In response the Joint Committee in Parliament demanded on Friday 23 October 2015 that Treasury give it a list of municipalities that defaulted on their accounts with Eskom.¹³⁵ On 16 November 2015, Treasury submitted the list¹³⁶ of reneging municipalities to the Joint Committee showing that most (almost a dozen) of the municipalities are in the Free State with the rest of the municipalities from the Eastern Cape, Mpumalanga, North West, Limpopo and the Northern Cape.¹³⁷ The Department of Co-operative Governance and Traditional Affairs official told Parliament the outstanding debt from these municipalities was around R4.5 billion.¹³⁸

Treasury said it had received responses from the municipalities on Friday, 13 November 2015 on why they should not be cut off from funding.¹³⁹ A senior official in co-operative governance told Parliament three weeks prior that some of the municipalities were struggling to pay Eskom because their debt was higher than their budgets.¹⁴⁰ Treasury said municipalities were not being punished by withdrawing funding, but rather being assisted to get their financial management systems on track and emphasised that municipalities must be able to collect revenue as this would help them to remain sustainable.¹⁴¹

On 27 November the National Treasury released a media statement discussing the issue of the reneging 27 municipalities, stating that Treasury had decided it would not invoke section 216 (2) of the Constitution against the municipalities.¹⁴² Instead, Treasury explained that it had

¹³² *Ibid.*

¹³³ *Ibid.*

¹³⁴ *Ibid.*

¹³⁵ *Ibid.*

¹³⁶ The list of 27 defaulting municipalities: Eastern Cape (Makana, Maletswa and Nxuba), Free State (Dihlabeng, Mafube, Maluti-A-Phofung, Mantsopa and Masilonyana, Matjhabeng, Nala, Ngwathe, Nketoana, Phumelela and Tokologo), Limpopo (Ba-Phalaborwa, Mookgophong and Thabazimbi), in Mpumalanga (Govan Mbeki, Mbombela and Khondo), lastly two North West municipalities, and five in the Northern Cape also still owe Eskom.

¹³⁷ Mkhwanazi S 'The National Treasury has named 27 municipalities that have reneged on their agreement to pay Eskom the billions they owed' (17 November 2015), article available at <http://www.iol.co.za/> (accessed 18/11/15).

¹³⁸ *Ibid.*

¹³⁹ *Ibid.*

¹⁴⁰ *Ibid.*

¹⁴¹ *Ibid.*

¹⁴² National Treasury, Media statement (27 November 2015) available at <http://www.treasury.gov.za/> (accessed 15/01/16).

decided to instruct finance MECs and the South African Local Government Association (SALGA) to support the municipalities.¹⁴³ SALGA has since been active in arranging for mediation among district municipalities, local municipalities, Eskom and the Water boards.¹⁴⁴

These are the facts that have transpired since the equitable share was withheld on 20 March 2015 up until December 2015, which will be used to assess the legality of the actions of National Treasury in invoking section 216 (2).

3 The legality of the financial intervention by National Treasury

The legality of Treasury's actions is dependent upon whether the substantive requirements as well as the procedural requirements set under the Constitution and the MFMA, have been met.

3.1 Substantive test of the financial intervention

The first step of the substantive test is to determine whether there has been a breach of one of the grounds listed in terms of section 216(1)(a-c). Based on the facts, the National Treasury invoked section 216 (2) because the affected municipalities were in breach of their financial obligations when they were owing Eskom and the water boards debt in arrears, meaning the municipalities had not taken reasonable steps to pay these particular creditors within 30 days after receiving invoices for payment from them. In chapter 2, it was established that 'payment to a creditor within 30 days after receiving the invoice' does fall within one of the grounds listed under section 216 (1), but more specifically section 216 (1)(c) the uniform norms and standards of the National Treasury. The link is the fact that the MFMA is an established source of Treasury norms and standards for municipalities and does provide that the accounting officer of a municipality should endeavour to pay creditors within 30 days of receiving invoices.¹⁴⁵ While this Treasury norm for payment within 30 days to creditors¹⁴⁶ serves as a guideline for the accounting officer of a municipality it does not specify which creditors should be prioritised for payment.

¹⁴³ *Ibid.*

¹⁴⁴ Magubane K 'Eskom gives councils time to pay up before pulling plug' (30 November 2015) article available at <http://www.bdlive.co.za/> (accessed 11/01/16).

¹⁴⁵ S. 65(2)(e) MFMA.

¹⁴⁶ See chapter 2 for a detailed look at the formula for the LES transfer.

The formula used to calculate the transfer amount for each municipality includes an amount tailored for that specific municipality to pay for costs to deliver free basic services (water and electricity) to the indigent households in its area, funds are available for the accounting officer to pay its creditors for the free basic services it provides. The Treasury has found that the 59 municipalities failed to make payment to Eskom and Water boards within 30 days after receiving invoices from Eskom and Water boards, meaning that the municipality failed to take the reasonable steps as the norm states. The evidence is that that these municipalities owe current as well as historical debt¹⁴⁷ thus amounting to a breach of the payment norm in terms of section 216(1)(c) of the Constitution.

Aside from their being a breach of the norm in terms of section 216(1) (c), the breach needs to also be material in order to invoke the remedy of section 216(2). The norm essentially places a duty on the municipality to pay its creditors within 30 days. It is submitted that the fact that the 59 municipalities *did not* pay, means it did not fulfil an essential part of its obligation in terms of this norm thus amounting to a material breach of section 216(1)(c).

The next part of the substantive test requires that the non-payment by municipalities has to be either serious or persistent, as this would qualify the materiality of the breach and justify whether Treasury needed to invoke the financial intervention against the defaulting municipalities. In order to ascertain whether the failure of the 59 municipalities to pay Eskom and the Water boards is *serious* or *persistent*, the definitions of the terms as explained in chapter 2 shall be applied to the facts. Simply put, the *seriousness* of the non-payment refers to whether the amounts owed in arrears was substantial in size while *persistent* non-payment would relate to the fact that non-payment has been occurring persistently over a period of time.

The debt owed to Eskom and the Water boards is substantial in quantity. Evidenced by the top twenty of the 59 defaulting municipalities owing Eskom a total of R4 billion as at December 2014,¹⁴⁸ with amounts amongst individual defaulters showing substantial debt such as R 201 million (City of Matlosana Local Municipality), R 214 million (Lekwa Local Municipality), R 299 million (Ngwathe Local Municipality), R 509 million (Matjhabeng Local Municipality) and the highest owed to Eskom peaking at R 562 million (Maluti-A-Phofung Local Municipality). The amounts owed to the water boards are just as substantial,

¹⁴⁷ National Treasury presentation to Standing Committee on Appropriations, 13 May 2015.

¹⁴⁸ Treasury records 'Municipal debt owed to Eskom and water boards' available from Linda Kruger (*National Treasury: Local Government Budget Analysis*) received by FFC (Dr Mkhululi Ncube) on 13 July 2015.

with cases like Mopani District Municipality owing R 339 million. The worst case was Matjhabeng Local Municipality, owing R 977 million.¹⁴⁹ On the available evidence it is not possible to assess whether each of the 59 municipalities had large amounts due to Eskom and the Water boards, but it is assumed to be the case.

Upon reviewing the amounts owed, it is hard to ignore the fact that these non-payments by the defaulting municipalities have been occurring habitually over a period of time as evidenced by the fact that the majority of the debt owed by the municipalities is shown as historical debt. For historical debt to occur it means that debt which was due on 30 days was not paid and would have accumulated to between 60 days to 120 days plus. For debt to accumulate over such a long period it means that at every 30 day period when the bill of the creditor is due for the payment, the defaulting municipality continues to *not* pay its bills as they become due, hence amounting to a persistent action of non-payment all the while increasing the amount of debt owed in arrears. National Treasury's reports¹⁵⁰ as submitted in Parliament shows how the majority of the municipalities continued to owe Eskom and the water boards every 30 days after the expected payment norm of 30 days had expired. The majority of the 59 defaulters have an amount owing to the creditors at every 30 days' time lapse, showing a persistent action of non-payment to the two creditors. Based on this evidence, it is assumed that all of the defaulting municipalities had historical debt. Matjhabeng Local Municipality, for instance, had not been paying Eskom since 2013 which is recorded as over '120 days plus'.¹⁵¹ Even City of Matlosana Local Municipality in the North West province, whose debt is among the highest owed to Eskom, has been in continuous arrears with Eskom since 2013.¹⁵² Therefore the conclusion can be drawn that the material breach of non-payment of the creditors by municipalities has also been persistent with certain defaulting municipalities.

In answering the question as to whether the National Treasury had substantial grounds for invoking section 216 (2) of the Constitution, one must conclude in the affirmative. The material breach by municipalities was both serious and persistent.

3.2 Procedural steps to be followed by the National Treasury

¹⁴⁹ *Ibid.*

¹⁵⁰ National Treasury presentation to Standing Committee on Appropriations, 13 May 2015.

¹⁵¹ *Ibid.*

¹⁵² 'Electricity disconnection to the Matlosana Municipality averted' (13 March 2013) article available at <http://www.eskom.co.za/> (accessed 11/01/16).

3.2.1 Consultation with affected municipalities prior to withholding the LES

Section 38(2) of the MFMA¹⁵³ requires that the National Treasury must engage in certain mandatory procedural steps *before* withholding the transfer from municipalities. The first step in this process requires that the National Treasury consult with the relevant municipality before withholding the LES transfer. The consultation in this process is mandatory and therefore if it is not done the actions of NT will be invalid.¹⁵⁴ The NT submitted in Parliament that there had been consultation with all municipalities and the organisation had records of all interactions generated under section 41 of the PFMA.¹⁵⁵ The consultation is prescribed in terms of the MFMA and not the PFMA. In order to determine whether the consultation was sufficient, there are three basic elements which constitute the process of consultation as developed from case law which will be tested against NT's actions.¹⁵⁶

a) An invitation to hear the views of the affected 59 municipalities.

Treasury must have given an invitation to the defaulting municipalities to hear their views on the matter of withholding the LES transfer before acting. Treasury sent a notice via email to the 59 defaulting municipalities on Friday evening 6.47 pm on 6 March 2015. The content of the memo included giving the defaulting municipalities a date by which they had to settle their debt in arrears to Eskom and the water boards and enter into payment agreements with the two creditors two weeks later or else their equitable share would be withheld.¹⁵⁷ The manner in which municipalities were notified goes contrary to the case precedent as there was no invitation to submit views by a given date in the memo to municipalities; it only stated that if by a certain date no payment was made and no payment agreement reached then the LES would be withheld. The municipalities expressed reservations about the notification they received via email because it was not from the Director-General of National Treasury.¹⁵⁸ The Chairperson of the Portfolio Committee meeting in Parliament said that the wording of the memo came across more as a warning to municipalities rather than an invite to hear their

¹⁵³ S 38 (2) MFMA.

¹⁵⁴ *Robertson v City of Cape Town* 2004 (9) BLCR 950 (C) at para. 75-76.

¹⁵⁵ FFC presentation to Standing Committee on Appropriations on withholding of LES allocations, 29 July 2015.

¹⁵⁶ Steytler & De Visser (2012) 16-13.

¹⁵⁷ In addition, the municipalities were required to request assistance with a financial recovery plan and provide a full list of its creditors to National Treasury arranged in order of priority (see National Treasury presentation to Portfolio Committee on Finance on debts owed to Eskom and Water Boards, 12 May 2015).

¹⁵⁸ SALGA presentation 'Withholding of equitable share to municipalities' Portfolio Committee meeting on Cooperative Governance and Traditional Affairs, 12 May 2015.

views.¹⁵⁹ Therefore, in applying the case precedent to the events that took place, the conclusion is that the invitation which NT presented to the affected municipalities does not amount to a ‘genuine invitation extended with a receptive mind, to give advice’ given the fact that the municipalities were threatened in the letter as well as the short time given to the municipalities in which to respond to the warning by NT.

b) Adequate opportunity given to municipalities to respond and furnish considered views.

There must have been adequate opportunity for municipalities to furnish NT with their considered views of why the withholding of transfers should not occur. Municipalities received the notice from NT on 6 March 2015, and were given until the 13 March to settle their debt with Eskom and water boards.¹⁶⁰ It is submitted that the time Treasury gave the defaulting municipalities to respond (which was not stated in the warning letter) is not equivalent to an adequate opportunity for municipalities to give a response to Treasury, let alone meet the payment deadline given which was set barely 5 working days after sending the notice. In order for a municipality to decide on a plan of action in dealing with such a pertinent notice from National government it would need to engage in (a) verification of the amount claimed, and (b) internal municipal processes of decision making. To convene a special meeting with its council members for this purpose requires at least 7 days’ notice and the time given to municipalities did not cater for this.¹⁶¹ It can therefore be concluded that the municipalities were not given an adequate opportunity in which to respond and furnish considered views on their equitable share being withheld. Organised local government (SALGA) as a representative body of the municipalities had also asked to meet with the Minister of Finance to discuss the issue but received no response.¹⁶²

c) Treasury must show consideration of the views of the municipalities in good faith.

¹⁵⁹ FFC presentation to Standing Committee on Appropriations on withholding of LES allocations, 29 July 2015.

¹⁶⁰ FFC presentation to Standing Committee on Appropriations on withholding of LES allocations, 29 July 2015.

¹⁶¹ SALGA presentation ‘Withholding of equitable share to municipalities’ Portfolio Committee meeting on Cooperative Governance and Traditional Affairs, 12 May 2015.

¹⁶² Mkhwanazi S ‘The National Treasury has named 27 municipalities that have reneged on their agreement to pay Eskom the billions they owed’ *Business News* 17 November 2015, available at <http://www.iol.co.za/>. (accessed 18/11/2015).

It is submitted that had NT truly intended to consider the views of the 59 defaulting municipalities, it would have provided for a later deadline than 20 March 2015 when it made the decision to withhold the equitable share. Had municipalities responded with furnished views by the deadline of 13 March regarding the LES being withheld from them, it would not have been possible for the NT to give due consideration to all 59 replies from the defaulting municipalities in order to make an informed decision.

After testing the efforts of the NT in complying with the consultation requirement prior to withholding the equitable share from the defaulting municipalities, it is clear that none of the basic elements of consultation was met. Further evidence of this lack of consultation is when Salga sought an urgent meeting with the Treasury officials on 1 April 2015 to deal with the concerns the affected municipalities had raised.¹⁶³ This is something that would not have been necessary had sufficient consultation taken place between the NT and the 59 affected municipalities.

The NT submitted in Parliament that it had been consulting with the municipalities since 2009 of which it had submitted records of meetings to the Portfolio committees. After reviewing these records of the meetings that NT refers to, it is evident that in the first place, none of the meetings involved discussing the pertinent issue of withholding the equitable share from the 59 municipalities. Whatever meetings did take place, they were not even attended by the affected municipalities, who are the most important stakeholders in the meetings considering that these are the meetings which NT considers as ‘consultation’ between itself and the municipalities.

In conclusion, it is submitted that there has been no consultation between NT and the 59 defaulting municipalities since 2009 on the issue of withholding their equitable share for debt in arrears to Eskom and the water boards. Further, there has been no consultation prior to withholding the equitable share as prescribed under the MFMA as the actions of NT do not meet the basic elements for consultation. Since there has been no consultation prior to withholding the equitable share from municipalities, the actions of NT are invalid as this procedural requirement has not been met.

¹⁶³ Salga presentation ‘Withholding of equitable share to municipalities’ Portfolio Committee meeting on Cooperative Governance and Traditional Affairs, 12 May 2015.

3.2.2 The affected MECs for local government needed to be informed by NT of its decision before the LES was withheld.

It is unclear about whether the MECs for local government were informed prior to the invocation of section 216(2) by NT. All that can be gathered from the facts is that at some point NT was in a meeting with the Presidential Infrastructure Coordinating Commission (PICC), and it is upon speculation that the MECs for Local government were in that meeting although the directive to Ministers to 'get their houses in order' cannot be translated into a clear meaning of withholding the equitable share from municipalities.¹⁶⁴ There was no specific mention of using invoking 216(2) for this purpose. On 20 June 2014, The North West Provincial Local Government was a party to a meeting held between NT and North-west Provincial Treasury to discuss debt owed to water boards but once again the specific issue of withholding the equitable share from municipalities was not on the agenda. In addition the meeting was held long before the intervention had taken place and therefore it is of no relevance. Eskom said it had been agreed by all local government MECs in the nine provinces that all municipal current bills would be honoured by October 2014. But this too does not amount to the MECs being notified of the equitable share being withheld from municipalities.¹⁶⁵ It is therefore submitted that the MEC for local government was not notified of the decision of National Treasury to invoke the intervention of section 216(2) against municipalities as legally required. The failure of the NT to inform the affected MEC of local government does not, however, affect the validity of the intervention. It is a mere informational duty, rather than being essential to NT's own decision-making.

3.3 Procedure for approval and review of National Treasury's decision by Parliament

In terms of the procedural requirements laid out in chapter 2 of this paper, both the National Assembly (NA) and the National Council of Provinces (NCOP) need to approve the National Treasury's decision to withhold the local government equitable share. The approval process is found in section 75 of the Constitution, but the approval must be done within 30 days after the National Treasury's decision was made. The date by which this approval should have taken place was thus on 20 April 2015.

¹⁶⁴ See minutes of Standing Committee meeting on Appropriations, 29 July 2015.

¹⁶⁵ Pressly D (2015) 'Municipalities owe Eskom R10bn' article available at <http://www.fin24.com/> (accessed 14/7/2015).

The first presentation regarding the stoppage of the LES transfer to municipalities was made to the National Assembly in Parliament only on 12 May 2015 which is well over the prescribed due date of 20 April 2015.¹⁶⁶ There was also no meeting, let alone a decision by the NCOP before this date. Therefore it is safe to conclude that because Parliament did not approve the National Treasury's decision within the prescribed time period - the intervention lapsed. The invalid decision could also not be validated by approval after 20 April 2015. Since the approval was not given by Parliament (the NA and the NCOP) within the specified time, the intervention should have lapsed retrospectively.

4 Conclusion

The stopping of LES transfers has to be done in the manner prescribed, both, substantively and procedurally in order for it to be legally valid.

In this chapter, it was shown that the National Treasury did have substantial grounds upon which to withhold the LES transfer from defaulting municipalities. This is premised on the fact that a norm for payment within 30 days is provided for in section 216(1)(c) and further, that the defaulting municipalities had seriously *and* persistently materially breached this National Treasury norm giving grounds for invoking section 216(2).

With regards to the procedural requirements for invoking section 216(2), they were not met. First there was no consultation between the National Treasury and the 59 defaulting municipalities *prior* to NT withholding the LES transfer. The consultation that the NT did engage in was found to be insufficient in meeting the basic elements of what consultation entails.

Secondly, the MEC for local government was not informed of the decision made by the National Treasury to institute the intervention. Most importantly, there was no approval given by the NA and the NCOP within 30 days of the intervention being enforced by NT. The failure of Parliament to approve within the prescribed 30 days means that the decision to withhold the transfer should have lapsed retrospectively. While chapter 2 made an argument for public participation to have occurred in the legislative process of Parliamentary approval

¹⁶⁶ See National Treasury presentation to Portfolio Committee on debts owed to Eskom and Water Boards, 12 May 2015.

of Treasury's decision, in light of the fact that there was no approval in the prescribed time, this point will remain untested here.

In conclusion, the legality of the actions of the National Treasury falls short when it comes to the procedural requirements of the Constitution. It is important to preserve the supremacy of the Constitution and follow the requirements it sets out in order to adhere to the principles of rule of law and good governance. Since both the substantive and procedural requirements need to be met, the fact that National Treasury failed to comply with the procedural requirements means that the intervention invoked using section 216(2) against municipalities was illegal.

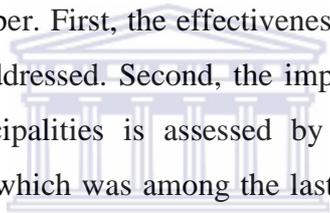


Chapter 4

The value of using section 216(2) for financial intervention against defaulting municipalities

1 Introduction

While the legality of the National Treasury's actions has been dealt with in Chapter 3, it is also important to assess the value of using the section 216(2) intervention as a first resort to address the problem of non-paying municipalities to its creditors. This chapter deals with two factors that can be used to assess the value of invoking section 216(2) as a financial intervention to remedy erring municipalities and will draw on the same facts that were presented in Chapter 3 of this paper. First, the effectiveness of using the intervention to deal with the non-payment issue is addressed. Second, the impact that the financial intervention has had on the affected municipalities is assessed by drawing on the experiences of Ventersdorp Local Municipality which was among the last three municipalities to enter into payment terms with Eskom.


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2 Effectiveness against defaulting municipalities

Since the intervention had been enforced on 20 March 2015, an announcement was made on 5 June 2015 by Eskom which tweeted, without revealing the names of the municipalities involved that “municipalities have to comply consistently with payment agreement terms on a monthly basis. If these conditions are not met, interruptions of supply will be implemented without further notice”. For the three outstanding municipalities, Eskom said it was “contemplating” a regulated interruption of electricity on Monday to Friday from 06:00 to 10:00 and 17:00 to 21:00, and on Saturday and Sunday from 07:00 to 10:00 and 17:00 to 20:00.”¹⁶⁷

The “three outstanding municipalities” to which Eskom referred, were confirmed in Parliament, on 29 July 2015 (eleven weeks after withholding the LES transfer) to be the

¹⁶⁷ ‘Municipalities hear Eskom's threat and pay up’ (29 May 2015) article available at <http://www.fin24.com/> (accessed 14/7/15).

Ngwathe, Ventersdorp and Renosterberg Local Municipalities.¹⁶⁸ National Treasury submitted that all but these three municipalities had entered into payment agreements with Eskom and water boards.¹⁶⁹

While this financial intervention may on the face of it appear effective, it was only successful in securing signed payment agreements between the creditors and the defaulting municipalities. In reality, the intervention has been ineffective in addressing non-payment by municipalities to their creditors. A mere three months after National Treasury announced in Parliament on 29 July 2015 that payment agreements were signed by 56 municipalities, newspapers reported on 27 October 2015 that 27 of the defaulting municipalities which had signed agreements with Eskom had reneged on their commitments to make payment to Eskom in terms of their signed payment terms. The National Treasury once again, found itself threatening to invoke section 216(2) and withhold the equitable share from these erring 27 municipalities which were now failing to honour their commitments and make up the majority of the original 59 defaulters.¹⁷⁰ The 27 municipalities had not been making any payment of their debt to Eskom since signing the payment agreements earlier in the 2015 only in order to have their equitable share released. The National Treasury gave a statement to the media that the aim of using the intervention was to assist the defaulting municipalities to get their financial management systems on track and to enable them to collect revenue as this would help them remain sustainable.¹⁷¹

In light of these events since the intervention was invoked 9 months ago¹⁷², the fact that the majority of the 59 defaulting municipalities are still not regularly paying Eskom even though National Treasury invoked an intervention in terms of section 216(2) proves that the intervention has not been as an effective method in dealing with non-payment of municipalities to creditors as one would expect it would be. Further, the National Treasury

¹⁶⁸ FFC presentation to Standing Committee on Appropriations on withholding of LES allocations, 29 July 2015.

¹⁶⁹ *Ibid.*

Further, municipalities under the intervention were eager to sign payment agreements in time before the start of their new financial year beginning on 1 July 2015.

¹⁷⁰ Mkhwanazi S 'Eskom is owed R9 billion: Treasury acts' (27 October 2015) article available at <http://www.iol.co.za/> (18/11/15).

¹⁷¹ Mkhwanazi S 'The National Treasury has named 27 municipalities that have reneged on their agreement to pay Eskom the billions they owed' (17 November 2015) article available at <http://www.iol.co.za/> (accessed 18/11/15).

¹⁷² Dated from 20 March until end of December 2015.

initially sent the 27 reneging municipalities a warning on 20 October 2015¹⁷³ that their LES would be withheld from them once again if they failed to make payment to Eskom as per the agreement. It is argued that the National Treasury could foresee that to invoke the intervention yet again would not yield the desired results of ensuring the payment of debt by the defaulting Municipalities. The NT released a new statement on 27 November 2015 announcing that a decision had been made *not* to invoke section 216(2) financial intervention against these reneging municipalities.¹⁷⁴ Instead, the National Treasury would seek a remedy through the assistance of Salga who is in the process of holding joint discussions between Eskom and the 27 municipalities in order to deal with the matter.¹⁷⁵

Section 216(2) has been ineffective in changing the financial behaviour of the defaulting municipalities as the defaulters had signed the payment agreements for the purpose of the National Treasury releasing their equitable shares to them, but soon thereafter the majority of those who had signed continued defaulting on payments to their creditor, Eskom.

It is further submitted that the intervention has also been ineffective in changing the financial status of the defaulting municipalities. As was the case in the past, they had no money to pay Eskom and water boards hence falling into major arrears on debt owed. The municipalities are still in the same financial position they were in when the intervention was invoked- having no money to pay creditors- Eskom and water boards. The Salga was party to the negotiations which NT had with municipalities after the withholding of the LES transfer, said that there were many other factors that were underlying the issue of non-payment by municipalities, and that municipalities required support to deal with these issues.¹⁷⁶ The primary cause of this debt is an inability by the municipalities to collect the revenues owed to them for property rates and services provided. In many instances, this can be attributed to failing billing systems and inadequate credit control policies.¹⁷⁷

3 Impact of using section 216 (2) on defaulting municipalities

¹⁷³ Mkhwanazi S 'Eskom is owed R9bn: Treasury acts' (27 October 2015).

¹⁷⁴ National Treasury Media statement released 27 November 2015, available at <http://www.treasury.gov.za/> (accessed 15/01/16).

¹⁷⁵ *Ibid.*

¹⁷⁶ SALGA presentation 'Withholding of equitable share to municipalities' *Portfolio Committee meeting on Cooperative Governance and Traditional Affairs*, 12 May 2015.

¹⁷⁷ *Ibid.*

The impact of the National Treasury's decision to withhold the LES from defaulting municipalities has major implications on the affected municipalities and its residents. Apart from just withholding their equitable share, Eskom and the water boards threatened the defaulting municipalities that their water and electricity would be cut-off if the debts were not paid.¹⁷⁸ The LES is used to supplement delivery of basic services to poor households and even a temporary disruption in delivery of basic services would affect poor households the most. The municipalities, whose equitable share had been withheld, were also among the most reliant on the equitable share to remain viable and to sustain delivery of free basic services to the indigent in their areas. On 30 March 2015, Salga was advised by the affected municipalities that since the LES allocation was withheld, the municipalities were now battling to pay staff salaries, other creditors and to render general services.¹⁷⁹ Due to the time and space constraints, only one municipality has been selected out of the 59 defaulting municipalities to use as a case study, namely Ventersdorp Local Municipality. The aim was to have a brief look at the impact the financial intervention has had on the affected municipality.



3.1 Ventersdorp Local Municipality

Ventersdorp Local Municipality is one of the three municipalities which had still not entered into a payment agreement with Eskom in time for the new financial year (beginning 1 July 2015) and whose LES was withheld and only released on 18 July 2015.¹⁸⁰ The municipality is situated in the North West province and falls under the Dr Kenneth Kaunda District Municipality. Apart from catering to its paying residents in Ventersdorp, there is a nearby township of Tshing which has a population of nearly 17,900 for which the municipality must provide free basic services as the residents are indigent.

The municipality had incurred its debt with Eskom due to the fact that big businesses¹⁸¹ in the area were not honouring payment of their electricity bills owed to the municipality. During the telephonic interview with the Municipality Expenditure Manager (Ms Esmarie Hall), the

¹⁷⁸ Ferreira E 'SALGA declares dispute with Treasury over Eskom debt' *Mail & Guardian* 14 May 2015.

¹⁷⁹ SALGA presentation 'Withholding of equitable share to municipalities' *Portfolio Committee meeting on Cooperative Governance and Traditional Affairs*, 12 May 2015.

¹⁸⁰ Telephonic interview held between Abdool Rahim, N and Ms Esmarie Hall (Manager of municipal expenditure at Ventersdorp local municipality (NW401)) on 19 July 2015.

¹⁸¹ The retail big business SPAR owed the municipality R 1.8 billion for unpaid electricity bills. The municipality was in the process of seeking a court order against the ex-owner of SPAR who was responsible for incurring the huge debt, however the delinquent ex-owner fled Ventersdorp area.

municipality said that it was more than 90 percent dependant on its LES transfer. Further that it used most of its LES transfer to pay Eskom, and the reason it was in arrears was because it could not keep up with payment of the current and backlog debt due to Eskom. One of the main reasons the municipality struggled to keep up with the debt owed to Eskom is because of Eskom's added interest to the debt owing, calculated at a high premium rate, against debt 15 days over the payment deadline.¹⁸² The municipality was also in the process of issuing a court order against the ex-owner of a private business 'SPAR' who had not paid his electricity bill of R 1.8 billion to the municipality.

It was submitted in Parliament by CoGTA that it is in fact problematic when a municipality resorts to using their equitable share to pay for bulk purchases to Eskom (as Ventersdorp local municipality has done) because the equitable share is meant to deal with poor households while other households should be paying for the services received.¹⁸³

Once the equitable share was withheld from the municipality, in order to remain viable all money that was available was focused on paying its staff's salaries until the equitable share was released to the municipality four months later (on 18 July 2015).

The withholding of the LES has impacted negatively on Ventersdorp Local Municipality. The municipality was placed in the vulnerable position of not being able to settle the accounts of its other creditors whilst relying on these creditors to provide uninterrupted services to the municipality. Fortunately the other creditors had agreed to provide services until such time as the equitable share could be released.¹⁸⁴ This may cause that other smaller creditors run the risk of bankruptcy when a municipality uses its resources to remain viable instead of paying its creditors, which may include small, black-owned businesses. All creditors need to receive payment to remain viable themselves and to continue to deliver services to the municipality apart from paying its own employees' salaries.

The other creditors of the municipality have had no other alternative but to wait for the municipality to receive its equitable share. Even Eskom was among the negatively affected creditors, as the impacted municipalities struggled to meet their current account to Eskom and

¹⁸² Telephonic interview held between Ms Naushina Abdool Rahim and Ms Esmarie Hall (Manager of municipal expenditure at Ventersdorp local municipality (NW401)) on 19 July 2015.

¹⁸³ CoGTA briefing to Portfolio Committee on Appropriations on the reasons for withholding equitable share allocations from municipalities, 12 May 2015.

¹⁸⁴ SALGA presentation 'Withholding of equitable share to municipalities' *Portfolio Committee meeting on Cooperative Governance and Traditional Affairs*, 12 May 2015.

water boards after the LES was withheld.¹⁸⁵ Ventersdorp Local Municipality is just one example of how a municipality had to remain viable through this financial crisis and deliver services uninterrupted to all its residents without receiving 90 per cent of its revenue.

On the issue of the impact the intervention would have had on paying residents if Eskom had to cut off electricity supply to residents as it had threatened to do publicly.¹⁸⁶ During the interview the Expenditure Manager stated that it was fortunate that Eskom had not interrupted its supply of electricity to the municipality. If Eskom had followed through on its threat to cut off power to the municipality it would have meant that residents who had been dutifully making payments for services in the area would be unfairly reprimanded if their defaulting municipality were to be deprived of the same services. The other group of residents who would be likely to suffer would be the indigent residents in the defaulting municipality's area as they relied on the delivery of free basic services for day-to-day survival.

In addressing these concerns of Eskom cutting off power to defaulting municipalities, the National Treasury responded that its objective in invoking the financial intervention was not to make the poor suffer and that none of the municipalities had their electricity or water cut off since the intervention had been enforced.¹⁸⁷ In response, the Chairperson of the Standing Committee on Appropriations said that even though a municipality's water and electricity had not been cut off, the fact remains that other services reliant on payment from the equitable share money would have been jeopardised hence still affecting residents (paying and non-paying alike).¹⁸⁸

4 Conclusion

It was shown above that the intervention has been ineffective in bringing forth payment from the defaulting municipalities as the majority of the defaulting municipalities who had

¹⁸⁵ SALGA presentation 'Withholding of equitable share to municipalities' *Portfolio Committee meeting on Cooperative Governance and Traditional Affairs*, 12 May 2015.

¹⁸⁶ Refer to 5 June 2015, when Eskom tweeted, without giving their names 'for the three outstanding municipalities, Eskom said it was "contemplating" a regulated interruption of electricity on Monday to Friday from 06:00 to 10:00 and 17:00 to 21:00, and on Saturday and Sunday from 07:00 to 10:00 and 17:00 to 20:00.'" (News article 'Municipalities hear Eskom's threat and pay up' available at <http://www.fin24.com/> (accessed 14/7/15)).

¹⁸⁷ *Ibid.*

¹⁸⁸ Standing Committee on Appropriations on withholding of LES allocations, 29 July 2015.

committed to payment by signing the payment agreements with creditors, have since reneged on those agreements. The 59 municipalities all fall into the range of being smaller, rural-based municipalities meaning that the majority of the residents in those areas have a lower income in comparison to residents in urban areas. The reason why the type of residents living in the defaulting municipalities is of significance is because the aim of invoking the intervention was to change the behaviour of the defaulting municipalities. As mentioned earlier, one of the underlying causes leading to non-payment by the municipalities was that they were failing to collect revenue from residents. The aim of the intervention was essentially a threat for the municipality to change its behaviour in the way it dealt with its revenue collections. National Treasury sought to address this issue by using the intervention to put pressure on the defaulting municipalities to in turn, place more pressure on its residents. The desired result being that there would be an increase in the outstanding revenue collected from its residents. However, the residents in the defaulting municipalities are struggling to pay and have a low-income financial status, meaning that the intervention would be ineffective in changing the behaviour of the municipalities when their residents are poor.

The impact that the intervention has had on the defaulting municipalities was a negative effect on the municipality and its other creditors. Due to its extreme dependency on the LES transfer, this municipality had to use whatever funds it had available to pay its staff salaries in order to remain viable so that it could continue to deliver services to all its residents (paying residents and indigent alike). It had negotiated with other smaller creditors that they would receive payment as soon as the LES was released. This means that for four months¹⁸⁹ the municipality focused on salaries and the other creditors received no income while providing services. Although none of the services were cut by Eskom and the Water boards, the municipality was left in a very vulnerable position while being responsible for service delivery to indigent residents.

By drawing on the findings of both the effectiveness and the impact of the intervention, the conclusion is that there was limited value in using section 216(2) as an intervention. It was not particularly effective in getting the 59 defaulting municipalities to pay off their debt in arrears to Eskom and water boards. The intervention of withholding the LES transfer from these municipalities was not effective as a first resort in addressing non-payment. After discussing the impact on the affected municipality, one can conclude that it did not contribute

¹⁸⁹ LES was withheld on 20 March 2015 and released to Ventersdorp Local Municipality on 18 July 2015.

to the value of using such an intervention against a municipality as the municipalities were very reliant on their LES and their viability was put at stake during the period until release.

This intervention in terms of section 139(5) of the Constitution would *prima facie* find application in dealing with the affected 59 defaulting municipalities which, as mentioned earlier, are clearly experiencing a crisis in their state of finances affairs and as a result are failing in their obligations to pay their creditors and hence failing to meet their financial commitments. While, national and provincial government also have a constitutional duty to support local government to strengthen its capacity and manage its own affairs.¹⁹⁰ This “support” does not include paying off a municipality’s debts; provinces simply do not have the resources to do so. Also the Supreme Court of Appeal¹⁹¹ held that while a provincial government has no constitutional duty towards a local authority in terms of section 154 of the Constitution to provide it with funds to enable the local authority to pay its debts, it may include measures that would lead to the payment of outstanding amounts in the above institutions.¹⁹² An example of such a measure would be to fulfil the role of helping to strengthen and build the capacity of local government to manage its own affairs. The most fitting measure to address the financial crisis the defaulting municipalities are in, is the financial recovery plan in terms of section 139(5)(a). Should the municipal council not want to implement the financial recovery plan then according to the mandatory wording of section 139(5), the council *must* be dissolved and the Provincial Executive must assume responsibility for the implementation of the recovery plan. However section 139(5)(c) allows for the scenario of the municipal council not being dissolved and the Provincial Executive assuming responsibility over the financial recovery plan in so far as the municipal council agrees to implement.

¹⁹⁰ S 154(1) Constitution “The national government and provincial governments, by legislative and other measures, must support and strengthen the capacity of municipalities to manage their own affairs, to exercise their powers and to perform their functions.”

¹⁹¹ *Member of the Executive Council for Local Government: Mpumalanga, Padayachee NO v Independent Municipal and Allied Trade Union ("Imatu") and Others* 2002 (1) SA 76 (SCA) para 5.

¹⁹² It is important to note that the Ngaka Modiri Molema District Municipality in the North West Province, ranking amongst the top five of the defaulting municipalities for the amount owed to Eskom and the Water boards, was under administration in terms of the section 139 intervention when its equitable share was withheld by the National Treasury.

Chapter 5

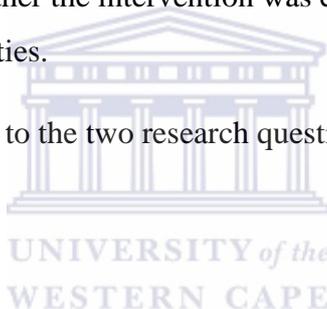
Conclusion

1 Introduction

The aim of this research paper has been to answer the question whether the actions of the National Treasury in invoking section 216(2) of the Constitution in respect of the 59 municipalities for debt owed in arrears to the creditors Eskom and the water boards, has been legal. Did its decision meet the substantive requirements as well as the procedural requirements as set under the legal framework of the Constitution and the MFMA?

The second question was to assess the value in using the intervention against defaulting municipalities, by looking at whether the intervention was effective and what impact did it have on the defaulting municipalities.

This chapter presents the findings to the two research questions and then concludes with a few recommendations.



2 Findings on the legal content of section 216 (2)

In dealing with the question of whether payment to creditors within the prescribed period of 30 days by municipalities - the grounds upon which the National Treasury used to invoke section 216(2) – can be a justifiable ground for invoking section 216(2), the following findings were made:

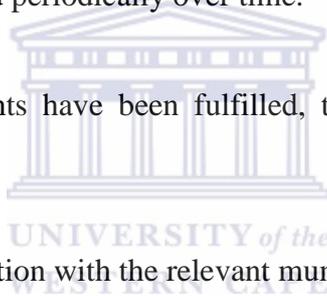
The first finding was that only section 216(1)(c), dealing with the norms and standards of the National Treasury, could apply in respect to this grounds of ‘payment to creditors within 30 days’. The reason for this is that the MFMA does fall within the broad ambit making up the sources of the norms and standards of the National Treasury which directly apply to municipalities. The MFMA gives statutory guidelines for municipalities to endeavour to make payment to its creditors within 30 days after receiving an invoice from the creditor, this is under section 65(2)(e) of the MFMA. Therefore, in answer to the question of whether ‘payment to creditors within 30 days’ as provided for under the MFMA, a norm or standard

in terms of section 216 (1), the answer is yes: reasonable steps to pay within 30 days is a norm and standard of the National Treasury. Furthermore, if no reasonable steps have been taken by the municipality to pay its creditors within the 30 day period then there is a breach of the norm.

In terms of section 216(2) there must be a material breach of the payment norm. The breach becomes material if it relates to the non-payment of the norm and because the defaulting municipalities did not endeavour to make the payment within 30 days; their breach of the norm is indeed a material breach. Upon the interpretation of the wording under the financial intervention the following findings were made.

According to section 216(2), the materiality of the breach is qualified by the seriousness of the non-payment i.e. the substantial amount of the debt owed or the persistence of the non-payment i.e. the debt has occurred periodically over time.

Once the substantive requirements have been fulfilled, the procedural requirements must follow:



Treasury must engage in consultation with the relevant municipalities prior to withholding the LES transfer in terms of the MFMA¹⁹³ and the Constitution.¹⁹⁴ The consultation must begin with an invitation to hear the views of the affected party on a specified matter. There must be adequate opportunity for the affected party to furnish considered views, and NT must give consideration to those views in good faith.

These are the requirements for valid consultation to occur and failure to do so thus affects the validity of NT's decision. The latter also needs to inform the MEC for local government of its decision to withhold the LES transfer; however, non-compliance with this duty does not affect the validity of the decision.

Once the decision has been taken, Parliament must approve the LES transfer stoppage in terms of the following procedure: both the NA and the NCOP, sitting separately, need to approve the decision taken by NT to withhold the transfer within 30 days of it being made. The process to be followed is that of passing a bill in terms of section 75 of the Constitution.

¹⁹³ S 38(2) MFMA.

¹⁹⁴ S 41(1) (h) (iii) Constitution.

There is a duty on the NA and the NCOP to facilitate public participation in their legislative processes, including the section 73 process which precedes section 75 in deliberating over NT's decision. Parliament may renew the decision to withhold the transfer but not for longer than 120 days at a time.

3 Findings on the application to the facts

The defaulting municipalities had failed to make payment to creditors Eskom and the Water boards. This fact evidences that the defaulting municipalities did not take the reasonable steps to make payment within the 30 days as the norm requires. Therefore, there was a breach of the payment norm in terms of section 216(1)(c) thus giving meeting the first substantive requirement of the intervention.

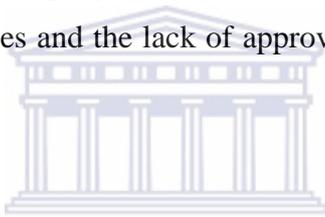
In testing the seriousness of the material breach, it was found that the amounts owed by all of the 59 municipalities were substantial in value and therefore serious. Further, the material breach was also persistent because the debt owed by the 59 defaulting municipalities had been occurring consistently over time, leading up to the accumulation of the substantial amounts referred to above. The findings showed that there was a serious and persistent material breach of the NT norms and standards. Therefore, the latter did meet the substantive grounds as required by section 216(2) to invoke the financial intervention in respect of the 59 municipalities.

In terms of the MFMA, the NT must engage in consultation with the relevant municipalities prior to invoking the intervention. The findings show that there was no such consultation with the 59 municipalities prior to the withholding of the LES. While the NT submitted records of meetings that had taken place since 2009 in Parliament, the meetings implied, did not meet the requirement of consultation. The findings made in the application in Chapter 3 shows that these meetings could not amount to consultation on the withholding of the LES because in none of these meetings, did the issue of withholding the LES from the municipalities become the main point of discussion. In addition, consultation with every single one of the 59 defaulting municipalities had to have occurred, this was not the case. When consultation becomes a validity requirement for the legislation in question, as in this case, the effect is that the actions of the NT in not consulting with the affected 59 municipalities prior to withholding the LES as prescribed in the legislation, amounts to a breach of the procedural requirements for section 216. The NT's actions of withholding the LES cannot be legal based

on this lack of consultation with the 59 affected municipalities even though the NT may have had substantial grounds for invoking the intervention, the procedural requirements need to be complied with in order to be constitutional.

It was required that Parliament approves the decision taken by the NT within 30 days of it being made. However, this did not occur in the prescribed time limit of 30 days. The failure of Parliament to approve Treasury's decision within the prescribed 30 days means that the decision to withhold the transfer should have lapsed retrospectively.

The findings in relation to answering the first research question shows that the NT failed to comply with the procedural requirements for invoking section 216(2) of the Constitution. Therefore, it can be concluded that while the NT may have had substantive grounds for invoking the intervention, it did not fully meet the procedural requirements. The NT thus withheld the transfer of the LES illegally from the 59 municipalities because of its lack of consultation with the municipalities and the lack of approval from Parliament of its decision to withhold the transfer.



4 Findings on the value of section 216 (2)

In dealing with the second research question of whether there was any value in using the intervention against defaulting municipalities, the effectiveness of the intervention in terms of receiving payment from non-paying municipalities' has been looked at. Further, the case-study on Ventersdorp Local Municipality gives insight into the impact the intervention has had on affected municipalities, its residents and its other creditors.

On the point of effectiveness, the findings are that the intervention has been ineffective in bringing forth payment from the defaulting municipalities. Initially it looked as if the intervention was working because the municipalities signed payment agreements with the two creditors Eskom and the water Boards when their LES was withheld. Once they had signed, their LES was released. Unfortunately, more than half of the municipalities that had signed the payment agreements soon reneged on their commitments to pay Eskom. This is evidence of the fact the intervention has been ineffective in bringing forth payment and affecting the behaviour of non-paying municipalities.

The municipalities are still struggling with the same issues it had since the first time the intervention was imposed. The intervention has not done anything to address the underlying issues of the non-payment itself. One of the underlying causes leading to non-payment by the municipalities was that they were failing to collect revenue from residents. The municipalities who are struggling to pay have been identified as poor-rural municipalities, poor in the sense that they cannot raise their own revenue as do most urban based metropolitan municipalities. The aim of the intervention was essentially a threat for the municipality to change its behaviour in the way it dealt with its revenue collections. By placing pressure on municipalities through the use of the intervention, the desire was that the municipalities would in turn place more pressure on residents to pay. The defaulting municipalities are in areas where the residents are poor and many are indigent, meaning that they are dependent on the municipality for delivery of free basic services. Big business that owes on outstanding bills to the municipality is also in a similar situation of having a low income consumer base.

The case study of Ventersdorp Local Municipality has been used to give insight into the impact the intervention has had on the municipality and its residents as well as other creditors. The findings are that the intervention has had a negative impact on the municipality. The reason for this is that the municipality has been over 90 percent dependent on its LES transfer over the years. Once its LES was withheld, the municipality had to use whatever funds it had available to pay its staff salaries in order to remain viable. To remain viable was crucial for its residents (paying residents and indigent alike), who are dependent on the small town municipality for delivery of basic services.

Although none of the services were cut by Eskom and the water boards, the municipality was left in a very vulnerable position while being responsible for service delivery to indigent residents. This means that for four months¹⁹⁵ the municipality focused on salaries and the other creditors received no payment from the municipality while providing services. It had negotiated with other smaller creditors that they would receive payment as soon as the LES was released.

Therefore, one can conclude that based on these findings from the case-study, there has in effect been limited value of using section 216(2) to address the issue of defaulting municipalities. It was not particularly effective in getting the 59 defaulting municipalities to pay off their debt in arrears to Eskom and the water boards. The withholding of the LES

¹⁹⁵ LES was withheld on 20 March 2015 and released to Ventersdorp Local Municipality on 18 July 2015.

transfer from these municipalities were not effective as a first resort in addressing non-payment and it has had a negative impact on the affected municipalities' viability and risked service delivery to paying and non-paying residents alike.

Another finding, which falls out of the main research questions of this paper but finds relevance to the application of the intervention in terms of section 216(2), is the debt owed to municipalities from other arms of government. The NT initially committed to ensuring it would enforce the same intervention on national and provincial spheres of government to collect the debt owed to municipalities, it has not done so.¹⁹⁶ Findings since July 2015, shows that the NT has gone contrary to its commitment, having expressed the fact that the amounts owed to municipalities by other spheres of government is merely a drop in the ocean compared to the debt owed by private households and business.¹⁹⁷ However, the amount owed to municipalities is only one of the considerations, the main point is that all spheres of government should be treated equally and if the intervention was applied to local government, then it should also be applied to the other two spheres of government to deal with their non-payment of services provided.

5 Recommendations

Section 216(2) of the Constitution does not give the NT a 'free hand', "steps" can only be "appropriate" to the extent that they also comply with the constitutional scheme governing the "interrelatedness"¹⁹⁸ between the national and local government. Therefore the NT expects that municipalities should comply with former norms and standards. Therefore, it should also apply the law itself in the manner prescribed in terms of the Constitution and legislation. Any intervention powers that the NT may draw from section 216(2) of the Constitution must comply with the requirements, both substantively and procedurally because of the vast effect the intervention has not only on the municipality who derives the majority of its income from the LES transfer but also the impact the withholding will have on residents should the intervention cripple a municipality's viability and functioning.

¹⁹⁶ FFC presentation to Standing Committee on Appropriations on withholding of LES allocations, 29 July 2015.

¹⁹⁷ National government departments owe municipalities R4.8-billion in unpaid services according to the department of co-operative governance and traditional affairs. The money owed by private households and businesses is R104-billion. (See article in *Mail & Guardian* 27 Sep 2015, available at <http://mg.co.za/> (accessed 8/12/15).

¹⁹⁸ See para 2.4 for interpretation on 'interrelatedness'.

Further, complying with the consultation process is a necessary tool for better decision making. It is submitted that the NT should not understate or overlook the importance of consultation with local government. The NT needs to engage in sufficient consultation with affected municipalities before it withholds the LES transfer as is prescribed under the procedural requirements for invoking section 216(2). Apart from fulfilling legal requirements, this process would be highly beneficial to both parties as the NT can address the correct municipalities and hear the views of the municipality in order to adequately provide the financial guidance and support the municipality is clearly in need of. Furthermore, municipalities will have the time to respond and to prepare for this interruption of its income. The needs of the residents can also be dealt with in a manner that will ensure there are no public protests as a result of a breakdown in service delivery.

Parliament, as the lawmaker, must itself comply with the law (MFMA) as these are the safeguards placed in the system to prevent an abuse of power from national government over local government.

Lastly, because section 216(2) has limited value, the NT must seek to use other methods to correct the systemic problem of non-payment amongst municipalities. The more appropriate measure against defaulting municipalities, who are in a debt crisis, would have been the use of section 139(5)(a) financial recovery plan. This intervention is specifically aimed at municipalities who are experiencing a financial crisis and as a result of its financial crisis it is in serious or persistent material breach of its obligations to meet its financial commitments. Certain challenges in the implementation of the financial recovery plan may arise if the municipal council refuses to implement the recovery plan either wholly or in part but this is a challenge that needs to be addressed going forward by legislatures and policy-makers.

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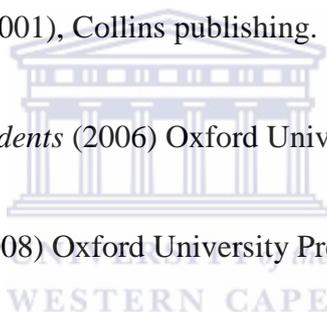
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