TO: **ESKOM HOLDINGS SOC LIMITED**

IN RE: **OPTIMUM COAL MINE (PTY) LTD (IN BUSINESS RESSCUE) // ESKOM HOLDINGS SOC LIMITED**

ATTENTION: **GROUP EXEC – TECH & COMMERCIAL**

MEMORANDUM

INTRODUCTION

1.

1.1. Consultant is ESKOM HOLDINGS SOC LIMITED ("Eskom").

1.2. We have been requested to provide Eskom with a memorandum regarding the assertion of its rights in terms of the Coal Supply Agreement, as amended ("CSA"), into which Eskom entered with OPTIMUM COAL MINE (PTY) LTD (in Business Rescue) ("OCM"), under a cession and assignment agreement.

1.3. The CSA is the primary agreement which regulates the supply and delivery of coal to Eskom's Hendrina Power Station ("Hendrina"), by

OCM, at prescribed quantities, qualities and price and was set for a fixed period ending in 2018.

1.4. This memorandum intends to consider the status of the CSA and the predicament Eskom finds itself in, pursuant to the recent events set out herein below.

BACKGROUND

2.

2.1. On 4 August 2015, the directors of OCM commenced business rescue proceedings citing that the company is financially distressed in accordance with chapter 6 of the Companies Act, 71 of 2008 ("the Companies Act") and nominated Piers Marsden and Petrus Francois van den Steen as its joint business practitioners in terms of section 129(3)(b) of the Companies Act (hereinafter referred to as "the business rescue practitioners");

2.2. On 17 August 2015, a meeting was convened between the business rescue practitioners and the representatives of Eskom in terms of which the business rescue practitioners:

2.2.1. reported that it was proving very difficult for OCM to continue on the terms of the existing CSA with Eskom and that it could not continue to produce coal under such terms, as it was unable to pay the cost of production;

2.2.2. discussed the alternatives available to OCM, which they were exploring as a possible outcome of the business rescue process as the following, to:

2.2.2.1. sell OCM as a going concern, subject to a successful renegotiation of the CSA with Eskom to relax the terms. (Their view was that the existing terms of the CSA would render the mine unattractive to any willing buyer); or

2.2.2.2. cease all operations and place OCM under care and maintenance until negotiations with Eskom are completed;

2.2.2.3. partially or completely discontinue coal supply to Eskom and re-open the export division of the mine and continue

business on the export side. (They were of the view that this will result in a great alleviation of losses); or

2.2.2.4. place OCM under liquidation, which in their view would result in zero recovery for creditors;

2.2.3. stated that they were contemplating serving Eskom with a notice to entirely, partially or conditionally suspend the CSA in terms of Section 136(2) of the Companies Act and that, in accordance with the same subsection, they also have the further right to cancel the CSA by way of an application to court, if Eskom does not co-operate.

2.3. On 20 August 2015, the business rescue practitioners, through their attorneys of record, delivered a letter to Eskom advising it that, they:

2.3.1. had reached a decision, in terms of section 136(2)(a) of the Companies Act, to entirely suspend the CSA, including all of OCM's obligations in terms of the agreement, with immediate effect, including, but not limited to, its obligation to supply coal to Eskom, for the duration of the business rescue proceedings;

2.3.2. were amenable to supplying coal to Eskom during the business rescue proceedings on terms which are acceptable to OCM and proposed an offer to supply coal to Eskom on terms set out in a draft agreement, attached to the letter and titled the “Interim Agreement”;

2.3.3. drew up the Interim Agreement based on principles negotiated between OCM and Eskom’s negotiating team pursuant to the Co-Operation Agreement; and

2.3.4. were giving Eskom time to consider the offer contained in the Interim Agreement, for acceptance, until 17h00 on Monday 24 August 2015.

PURPOSE OF THE MEMORANDUM

3.

3.1. On 21 August 2015, a meeting was convened between Eskom and its legal representatives to discuss the legal position Eskom finds itself in and the options available to it in light of:

3.1.1. the suspension of the CSA, with immediate effect, including the suspension of the supply of coal to Eskom pursuant to the section 136(2)(a) of the Companies Act; and

3.1.2. the offer contained in the Interim Agreement attached to the letter of suspension.

3.2. Pursuant to the discussions held, we were instructed to guide Eskom with regards to the following matters:

3.2.1. the prospects of successfully launching an application to remove the business rescue practitioners;

3.2.2. the enforceability of the CSA during the business rescue proceedings, due regard being had to the suspension of the CSA by the business rescue practitioners;

3.2.3. the effect of Eskom's refusal to negotiate with the business rescue practitioners pertaining to the terms of the Interim Agreement and the options available to Eskom in light of the section 136(2)(a) notice to suspend the supply of coal by the business rescue practitioners; and

3.2.4. the possibility of Eskom acquiring the mining rights of OCM so as to secure for itself a continuous supply of coal.

RECENT EVENTS

4.

4.1. On 20 August 2015, Eskom was served with a notice in terms of section 145(1) of the Companies Act informing it that Optrix Security Company (Pty) Ltd ("Optrix") had launched an urgent application to perfect its security held through a general notarial bond over the moveable assets of OCM, as security for the latter's indebtedness to Optrix, as a condition to Optrix (and/or the consortium of banks) providing OCM with post-commencement funding for its immediate working capital requirements.

4.2. Initially, our instructions were to defend the matter. Subsequent to numerous exchanges of correspondence, an agreement was reached between the legal representatives of Eskom and those of Optrix to the effect that Optrix would only seek an interim order, returnable on a later date, which was accordingly done.

4.3. A copy of the draft order made an order of Court on 21 August 2015 is attached to this memorandum.

REGULATORY FRAMEWORK & DISCUSSION

Role of business rescue practitioner and the prospects of success of an application to remove BRP in terms of Companies Act

5.

5.1. Part B of chapter 6 of the Companies Act provides for the regulation of business rescue practitioners on a dual basis, in the main. It involves the appointment of suitably qualified practitioners in accordance with the qualifications set out in section 128 and the monitoring of business rescue practitioners in their performance of business rescues.

5.2. A business rescue practitioner is defined in section 128(1)(d) which provides that a "business rescue practitioner" is "a person appointed, or two or more persons appointed jointly, in terms of this Chapter to oversee a company during business rescue proceedings…".

5.3. In terms of Section 40, the statutory role accorded to a business rescue practitioner, during the period of the business rescue proceedings is, *inter alia,* to exercise full management control of the company in substitution for its board and pre-existing management; act as an officer of the court; and to possess the responsibilities, duties and liabilities of a director of

the company, as set out in sections 75 to 77 of the Companies Act (naturally meaning that a business rescue practitioner has to act in the best interests of company and that he owes a fiduciary duty to the company in the exercise of his duties).

5.4. Accordingly, “business rescue” is defined in section 128 as:

> *“proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for:*
>
> *(i) the temporary supervision of the company, and of the management of its affairs, business and property;*
> *(ii) a temporary moratorium on the rights of claimants against the company or in respect of property in its possession;*
> *(iii) the development and implementation, if approved, of a plan to rescue the company by restructuring its affairs, business, property, debt and other liabilities, and equity in a manner that maximises the likelihood of the company continuing in existence on a solvent basis or, if it is not possible for the company to so continue in existence, results in a better return for the company’s creditors or shareholders than would result from the immediate liquidation of the company”.*

5.5. Sections 130(1)(b) and 139(2) provide for the removal of a business rescue practitioner and stipulate that same can only be effected by means of a court order by an affected person.

5.6. Section 130(1)(b) provides for the setting aside of the appointment of a business rescue practitioner, on application, at any time, after the adoption of a company resolution, to undergo business rescue proceedings and until the adoption of the business rescue plan on the grounds that s/he "does not meet the qualification requirements of section 138; is not independent of the company or its management; or lacks the necessary skills, having regard to the company's circumstances".

5.7. Section 139(2) states that a business rescue practitioner may be removed by an order of court on the following grounds:

> *"Incompetence or failure to perform the duties of a business rescue practitioner of the particular company; failure to exercise the proper degree of care in the performance of the practitioner's functions; engaging in illegal acts or conduct; if the practitioner no longer satisfies the requirements set out in section 138(1); conflict of interest or lack of independence; or the practitioner is incapacitated and unable to perform the functions of that office, and is unlikely to regain that capacity within a reasonable time."*

5.8. Accordingly, any application to remove and/or set aside the appointment of a business rescue practitioner is statutorily limited to the grounds cited

in sections 130 (setting aside) and 139 (removal) of the Act and substantiating same in a substantive application.

5.9. It is apparent from the above that the removal and/or setting aside of an appointment of a business rescue practitioner cannot be effected without judicial intervention and deliberation, for such an appointee is provided with the powers, responsibilities and rights of a director and is accorded the status of an officer of the court.

5.10. Business rescue practitioners are statutorily enjoined with fiduciary duties and are deemed to be acting with *bona fides* and in the best interests of a company undergoing business rescue proceedings. An application for their removal as business rescue practitioners, would require far more than mere speculation or bold allegations so as to discharge the onus on an applicant of proving any of the grounds set out in the Companies Act.

5.11. No compelling facts or reasons are presently known to us that would merit the removal of the business rescue practitioners. The practitioners appear to be acting in the best interest of the company. The fact that the company's interests and those of one or more of its creditors are not aligned, does not warrant the removal of the practitioners.

Eskom's legal rights as per the CSA, during the business rescue proceedings and under the CSA's suspension by the business rescue practitioners;

5.12. Section 133(1)(a) and (b) of the Companies Act provide that:

> *"during business rescue proceedings, no legal proceeding, including enforcement action, against the company, or in relation to any property belonging to the company, or lawfully in its possession, may be commenced or proceeded with in any forum, except:*
>
> *(a) with the written consent of the practitioner;*
>
> *(b) with the leave of the court and in accordance with any terms the court considers suitable..."*

5.13. Section 136(2) of the Act allows a company, through the business rescue practitioner, to temporarily or permanently extricate itself from onerous contractual provisions that are preventing it, or may prevent it, from becoming a successful concern.

5.14. The subsection provides that during business rescue proceedings, the business rescue practitioner may: (a) suspend (entirely, partially or conditionally) for the duration of the business rescue proceedings, any obligation of the company that: (i) arises under an agreement to which the company was a party at the commencement of the business rescue

proceedings, and (ii) would otherwise become due during those proceedings; or (b) apply to a court to cancel (entirely, partially or conditionally), on any terms that are just and reasonable in the circumstances, any obligation of the company in terms of that contract.

5.15. We are instructed that Eskom has a claim against OCM, pursuant to the penalty provisions of the CSA, in the sum of approximately R2.4 billion, comprising penalties and/or payment deductions in respect of the quality of coal supplied and delivered by OCM to Eskom over a specified period. As a result of the moratorium mandated by section 133 of the Act, Eskom is not permitted (save with the permission of the practitioner or the leave of the court) during the business rescue proceedings to proceed with any legal proceedings, including an enforcement order against OCM, for the recovery of the aforementioned penalties/payment deductions.

5.16. The obligations of OCM in terms of the CSA have, as pointed out above, been suspended, in their entirety, with immediate, by the business rescue practitioners with effect from 20 August 2015. This includes the immediate suspension of the supply of coal during the business rescue proceedings to Eskom.

5.17. Effectively, this means that all and any obligations that OCM had, as a party to the CSA, towards Eskom prior to the commencement of the business rescue proceedings are, during the business rescue proceedings, unenforceable by Eskom.

5.18. Although, for the purposes of cancelling the CSA, the business rescue practitioners cannot do so at a whim, they are statutorily enjoined to approach a court with a substantive application in terms of section 136 of the Act. In the event of such a cancellation, Eskom would, in terms of section 136(3) of the Act, be entitled to assert a claim for damages consequent upon such cancellation. (However, in the light of the present financial state of OCM, the extent of the damages that Eskom would be able to recover form OCM would be negligible.)

5.19. The letter suspending the CSA dated 19 August 2015, sent by the business rescue practitioners to Eskom, cites the failure by Eskom to effect payment of the amount of R29 826 301.71 for the month of July 2015, as per its letter dated 14 August 2015, as one of the reasons why the supply of coal was suspended with immediate effect.

5.20. Whilst the CSA has been suspended in its entirety, Eskom's obligation to pay such amount remains as the indebtedness in question arose prior to the suspension of the agreement. Eskom would however be entitled to

deduct from the amount payable any penalties that it may contractually be entitled to enforce.

Effect of Eskom's election in re: the Interim Agreement and options available to it

5.21. The business rescue practitioners have presented Eskom with an offer contained in the Interim Agreement, for the duration of the business rescue proceedings, attached to the letter of suspension dated 20 August 2015.

5.22. The material terms of the Interim Agreement are, *inter alia*, as follows:

5.22.1. the Interim Agreement would be extant until the date on which the business rescue proceedings end or a long term agreement is concluded between OCM and Eskom which would supersede the Interim Agreement;

5.22.2. OCM would supply Eskom and Eskom would purchase from OCM, 400 000 tons of coal per month (+/-10% at OCM's option), prorated per day for part months; and

5.22.3. Eskom would pay OCM R22.32 per GJ (moisture free) for coal delivered under the agreement.

5.23. The only binding agreement (albeit that it is presently suspended) that regulates the contractual relationship between Eskom and OCM is the CSA. The proposed Interim Agreement has no binding effect on Eskom and Eskom is under no obligation to accept its terms.

5.24. Eskom is entitled to preserve its rights in terms of the CSA (subject to the practitioner's entitlement, with the leave of the court, to cancel the agreement) and cannot be forced into an agreement that dictates the quality and price of the coal it ought to receive, even under the business rescue proceedings.

5.25. Eskom has the option to either accept or reject the proposed Interim Agreement or to negotiate terms more favourable to it and to make a counter offer to the business rescue practitioners.

OPTION 1: ACCEPTANCE

5.26. In the event that Eskom accepts the terms of the Interim Agreement offered by the business rescue practitioners for the duration of the business rescue proceedings:

5.26.1. Eskom would secure immediate coal supply, albeit that it would pay a significant premium for same in comparison to the underlying CSA;

5.26.2. Eskom would effectively be forfeiting its right to enforce any penalties against Optimum arising from the CSA for the duration of the Interim Agreement.

OPTION 2: REJECTION

5.27. In the event that Eskom rejects the terms of the Initial Agreement offered by the business rescue practitioners:

5.27.1. Eskom will have no contractual right (given the suspension of the CSA) to force Optimum to continue to supply it with coal;

5.27.2. Will be required to source and alternative coal supply, at a significantly higher cost when compared to the CSA tariff (but, so we understand, at a cost comparable to the tariff offered in terms of the Interim Agreement);

5.27.3. Eskom would be entitled to hold Optimum liable for the damages that it would suffer consequent upon the suspension (and ultimately, the cancellation) of the CSA. (We have however already pointed out that it is doubtful whether Eskom would ultimately be able to recover any meaningful damages from OCM, given its precarious financial position).

5.28. The rejection of the Interim Agreement will no doubt, in the fullness of time, also lead to the cancellation of the CSA. Eskom has no right to enforce the CSA (and thus no right to force OCM to continue to supply it with coal at the rates stipulated in the CSA). Again, in the event of the cancellation of the CSA, Eskom would be left with a largely meaningless claim for damages with all of the other consequences identified above.

OPTION 3: NEGOTIATION

5.29. Eskom may want to explore the possibility of negotiating the terms of the Interim Agreement with the business rescue practitioners on terms more favourable to it.

5.30. The most contentious of the clauses contained in the Interim Agreement are the ones dealing with the quality and price of the supply and delivery of coal by OCM to Eskom. Further, the fact that the Interim Agreement does not contain a clause dealing with penalties is likewise of concern. All the issues forming the various disputes between parties, emanating from the CSA, turn on these three fundamental aspects.

5.31. Pending the finalisation of the negotiations on a new agreement, be it the Interim Agreement as renegotiated and/or any other agreement to regulate the relationship between the parties, Eskom may want to consider entering into an interim arrangement and/or agreement with the business rescue practitioners in order to deal with its most pressing issue, namely uplifting of the suspension on the supply and delivery of coal to Hendrina.

5.32. In considering such an interim agreement/arrangement, Eskom would no doubt be expected to make payment of the outstanding invoice of OCM for the month of July 2015.

6.

ACQUISTION OF THE MINING RIGHTS

6.1. The CSA affords Eskom the right to acquire the mining venture of OCM on terms regulated by the CSA. The CSA has however been suspended, and so too Eskom's contractual right to acquire the mine. In the event of a cancellation of the CSA, Eskom will have no enforceable contractual right to acquire the mine.

6.2. Absent a contractual right to acquire the mine, Eskom is in no better position than any removed third party to acquire the mine. The following options are available to Eskom:

6.2.1. it can make an offer to acquire the mine on commercial terms from the business rescue practitioners;

6.2.2. it can propose a business rescue plan than provides for a compromise of the cliams of creditors and the acquisition of the mine; or

6.2.3. it can propose an arrangement and/or a compromise under section 155(2) of the Act.

Should consultant be minded to explore any of the aforementioned options, then we would propose that the various options be explored in a supplementary memorandum and/or discussion.

CONCLUSION

7.

7.1. In our view, there is no factual basis that would satisfy any of the grounds set out in the Companies Act upon which an application for the removal or setting aside of the appointment of the business rescue practitioners could be based.

7.2. With regards to the status of CSA and the respective rights and claims of both Eskom and OCM, all obligations under the CSA are suspended, pending the cancellation of the agreement by application to court; or the termination of the business rescue proceedings by notice. In the event of a cancellation, Eskom would unlikely be able to recover any meaningful damages from OCM due to its precarious financial position.

7.3. As indicated above, Eskom is under no obligation to accede to the terms of the Interim Agreement; however, it ought to consider proposing a

counter-offer on terms which it is willing to entertain and in respect of which it could possibly obtain a mandate from its board of directors.

7.4. This is more so, in light of the instructions provided to us to the effect that, amongst other factors, Eskom currently has no supply of coal; has not considered and/or identified an alternative supply to Hendrina and only has stockpile levels to last it 2 to 3 months (which would have to be transported by road hauling for the short term).

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