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DISPUTE RESOLUTION ALERT

Organs of state, be careful of the label attached to your RFB – it's a game of substance over form

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SA Express placed in business rescue

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Section 217 of the Constitution of the Republic of South Africa directs national, provincial or local spheres of government, or any other institution identified in national legislation to contract for goods or services in accordance with a system that is fair, equitable, transparent, competitive and cost-effective.

The ACSA's RFB intentionally deviated from the principles laid down in section 217 of the Constitution, procurement legislation, and policies on the contention that it was not contracting for goods and services in accordance with section 217 of the Constitution.

Imperial Group Limited objected to the deviation. The applicability of section 217 of the Constitution was thus considered by the Supreme Court of Appeal (SCA) in *Airports Company South Africa SOC Ltd v Imperial Group Ltd & Others* (1306/18) [2020] ZASCA 02.

The applicability of section 217 of the Constitution hinged on the interpretation of "procurement". The SCA held that the acquisition of goods and services is not limited to state expenditure. The definition of procurement "applies equally to obtaining goods and services for one's own use or for the use of others".

The SCA pointed out that the ACSA's answering affidavit was very telling as to the commercial nature of the RFB and in particular the following averments contained therein: "There is no dispute that ACSA had a commercial need to ensure that it leases its premises to successful bidders in order to ensure revenue generation".

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In applying the *substance over form principle*, the SCA analysed the purpose of the RFB and held that "the essence of the transaction is that ACSA contracts with car-rental companies to complete and enhance the services available to customers at its airports in accordance with its own mandate contemplated in the ACSA Act". Section 217 of the Constitution therefore applied.

Organs of state must be careful when drafting the parameters of their Request for Bids. The starting point is whether the true nature of the transaction is contracting for goods or services as provided for in section 217 of the Constitution. If the true nature of the transaction does fall within the purview of section 217 of the Constitution, then strict adherence to procurement legislation and policies must be followed. Otherwise, deviations will expose the procurement process to judicial review.

Rishaban Moodley and Neha Dhana

SA Express placed in business rescue

Ziegler's founding papers however made it clear that the primary focus of the application pertained to placing SA Express in business rescue.

On 6 February 2020, South Africa Express Airways SOC Ltd (SA Express), a state-owned airline, was placed into business rescue.

This was pursuant to an urgent application brought by Ziegler South Africa (Pty) Ltd (Ziegler), a provider of global logistics solutions, to place SA Express in business rescue in terms of section 131(1) of the Companies Act 71 of 2008 (Act).

In the alternative, Ziegler sought a final winding-up order in terms of section 344(f) of the Companies Act 61 of 1973 (old Act) on the basis that SA Express is unable to pay its debts. Ziegler's founding papers however made it clear that the primary focus of the application pertained to placing SA Express in business rescue. SA Express opposed the application.

Section 131(1) of the Act provides that an affected person may apply to court at any time for an order placing a company under supervision and commencing business rescue proceedings (an "affected person" includes a creditor of the company, such as Ziegler).

The urgent application was argued before Dippenaar J in the High Court of South Africa, Gauteng Local Division, Johannesburg (High Court).

Ziegler's case

Ziegler's case was based on an indebtedness of R11,294,966.80 as at 23 December 2019, which was due and payable to it by SA Express. The indebtedness stems from an agreement concluded with SA Express on 23 January 2017 (agreement), whereby Ziegler provided freight forwarding and custom clearing services.

Ziegler alleged that SA Express is financially distressed as envisaged by section 128(1)(b) of the Act and that there is a reasonable prospect of rescuing the company as envisaged by the aforesaid provision. It further contended that it is otherwise just and equitable for financial reasons to place SA Express in business rescue rather than in liquidation in the interests of other affected persons, particularly the majority of its creditors. Ziegler's primary case was that business rescue is preferable to its alternative claim for liquidation, as there is a prospect of saving the business.

Ziegler contended that the application was inherently urgent due to SA Express' dire financial position which could only worsen over time, exacerbated by South African Airways being placed in business rescue during December 2019.

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SA Express placed in business rescue ...continued

It is a well-recognised principle that commercial urgency can constitute urgency in certain circumstances.

SA Express' case

SA Express contended that the application lacked urgency as Ziegler did not demonstrate that it would not obtain substantial redress at a hearing in due course. SA Express further contended that a pending winding-up application for the winding-up of SA Express, which was due to be heard on 31 January 2020, had been removed from the roll, and as a result of the removal, Ziegler's business rescue application was no longer urgent.

SA Express further opposed the merits of the application on the grounds that:

- (1) the application constituted an abuse of the court process as it was instituted with an ulterior motive in relation to a disputed debt in an agreement which contains an arbitration clause (i.e. that the dispute resolution mechanism in the agreement ought to have been followed by Ziegler); and
- (2) Ziegler has not demonstrated a reasonable prospect for rescuing SA Express and thus the business rescue application must fail.

High Court's ruling on urgency and merits

Urgency

It is a well-recognised principle that commercial urgency can constitute urgency in certain circumstances.

In this matter, the High Court stated that there is inherent urgency in resolving the precarious financial position in which SA Express finds itself and the important consideration that it is reliant on public funding.

Considering the facts set out in the papers, the High Court held that the application was sufficiently urgent to entertain it on its merits.

Merits

(i) Abuse of process, disputed debt and arbitration

The High Court found that the application was not an abuse of court process.

It held, *inter alia*, that Ziegler was not attempting to obtain a monetary judgment against SA Express in the present proceedings and that the relief sought falls outside the powers and jurisdiction of an arbitrator.

The court was satisfied that, in motivating SA Express' indebtedness to it, Ziegler had illustrated its locus standi as a creditor and affected person as envisaged by section 128(1)(a) of the Act. It was further clear from the papers that Ziegler was not attempting to obtain payment of its claim in these proceedings, but rather seeking that SA Express be placed in business rescue.

(ii) Financially distressed

The High Court in its judgment stated that it was common cause between the parties that SA Express is financially distressed as envisaged by section 128(1)(f) of the Act.

The reasons provided by the High Court for the aforementioned conclusion included, *inter alia*:

- It was not disputed by SA Express that it is commercially insolvent and unable to pay its debts as and when they fall due;

SA Express placed in business rescue ...continued

The High Court indicated that it is not necessary for Ziegler to set out a summary of the proposed rescue plan in its papers. It is the duty of the business rescue practitioners to formulate a plan once a proper assessment of SA Express has been done.

- SA Express on its own version stated that: "it is a matter of public record that it, like all other state-owned entities, are facing serious financial challenges";
- SA Express further did not deny that it has had to rely on substantial cash injections from government since early 2017 to survive.
- It was also undisputed that at the time of the hearing no less than three winding-up applications have been launched against SA Express; and
- The 2019 financial statements of SA Express paint a picture of an entity in a dire financial crisis.

(iii) Reasonable prospect of rescue

The High Court stated that it is important to bear in mind the purpose of business rescue set out in section 7(k) of the Act, being to provide for the efficient rescue and recovery of financially stressed companies in a manner that balances the rights and interests of relevant stakeholders.

It is further important to bear in mind that business rescue proceedings are not for the terminally or chronically ill. They are for ailing corporations which, given time, will be rescued and become solvent.

The High Court emphasised that Ziegler is obliged to place before the Court a cogent evidential foundation that supports the existence of a reasonable prospect of rescuing SA Express.

The case made out by Ziegler in its founding papers is that, whilst SA Express is currently reliant on taxes, government guaranteed debt and resources from outside the aviation industry, it is inconceivable that SA Express would not be able to trade profitably if properly managed. It has various substantial assets, including a fleet of 24 aircraft and a valuable trade route network that provides flights *inter alia* to all major cities in South Africa, as well to neighbouring countries such as Namibia, Botswana, Zimbabwe and the Democratic Republic of Congo.

The High Court indicated that it is not necessary for Ziegler to set out a summary of the proposed rescue plan in its papers. It is the duty of the business rescue practitioners to formulate a plan once a proper assessment of SA Express has been done. Even if the business rescue practitioners are unable to secure sufficient funding for a successful rescue, the sale of SA Express may well yield a better return for creditors than its immediate liquidation.

The High Court acknowledged the disastrous effects that a liquidation of SA Express would have. Such consequences include:

- The South Africa would lose an asset that could, if properly managed, contribute significantly to the economy;

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SA Express placed in business rescue

...continued

The High Court concluded that all of the requirements in terms of Chapter 6 of the Act had been met and accordingly placed SA Express in business rescue.

- The government would be further burdened by the calling up of government guarantees;
- SA Express would lose its air licenses, Civil Aviation approvals and routes, which are all valuable assets and without which a sale of its business would be less attractive to potential buyers;
- A significant amount of jobs, in excess of 1000, would be lost, resulting in hardship for many families; and
- The fixed assets of SA Express would be sold at a forced sale value which would return a substantially lower amount than their market value.

The High Court further noted that an important factor to take into consideration is that, none of the other affected persons, including the government as shareholder, the employees and creditors of SA Express opposed the application, thus signaling at least acquiescence if not support for the attempt to rescue the company.

High Court's conclusion

The High Court stated that section 131(4) of the Act affords a court a discretion in a loose sense and requires of the court no more than a value judgment. The High Court held that Ziegler met the threshold

of illustrating a reasonable prospect as required by section 131(4). At the very least in all the circumstances, it would be in the interests of justice and the public interest to afford the business rescue practitioners the opportunity to investigate the affairs of SA Express and to formulate an appropriate business rescue plan.

The High Court stated that it is satisfied that the relevant provisions of Chapter 6 of the Act provide sufficient safeguards to ensure that the rights and interests of all affected persons will be protected and that the business rescue proceedings will be terminated if it proves to be a fruitless endeavour.

The High Court concluded that all of the requirements in terms of Chapter 6 of the Act had been met and accordingly placed SA Express in business rescue.

Intended appeal

At the time of writing this article, it appears from media reports that SA Express intends on appealing the judgment.

Two interim business rescue practitioners have been appointed in terms of the judgment. However, the appointment is subject to the ratification by the holders of the majority of the independent creditors at a first meeting of creditors to be convened in terms of section 147 of the Act.

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SA Express placed in business rescue ...continued

Ordinarily, the board of directors of a company which was placed under business rescue, may not take any action without the approval of the business rescue practitioner.

Ordinarily, the board of directors of a company which was placed under business rescue, may not take any action without the approval of the business rescue practitioner. The question then arises whether a board of directors could make a decision to apply to court for leave to appeal a judgment whereby a company was placed under business rescue.

It remains to be seen what effect the interim nature of the business rescue practitioners' appointment will have on an anticipated application for leave to appeal the judgment.

A follow up article will be written in due course, if necessary.

*Kylene Weyers, Tobie Jordaan
and Stephan Venter*

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