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BUSINESS RESCUE, RESTRUCTURING & INSOLVENCY

NEWSLETTER

CDH
CLIFFE DEKKER HOFMEYR

INCORPORATING
KIETI LAW LLP, KENYA

DISPUTE RESOLUTION

IN THIS ISSUE

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It would be remiss of us not to mention that we have entered Women's Month. Our women's soccer team, Banyana Banyana, made the entire nation proud as they were crowned queens of the continent for the first time after they defeated host Morocco at the Women's African Cup of Nations. Further news to be celebrated with particular emphasis on Women's Month is the appointment of Prof. Thuli Madonsela as chairperson of the management board of Cities Alliance, a global partnership fighting urban poverty and supporting cities to deliver sustainable development. The tourism industry is seeing a steady resurgence post pandemic and post lockdown, with Statistics SA reporting that there was an 86,6% increase in income for tourist accommodation for the year ending May 2022. In a case of celebrating some of our small victories, the price of petrol has decreased after numerous petrol price hikes.

On the other side of the coin, Statistics SA has also provided insight into how severe the financial impact has been for some industries and entities as the local and global community attempts to recover as we emerge from lockdown. The total number of liquidations in South Africa increased by 9,8% in June 2022 compared to June 2021. Comparatively, the recent data pointed to 145 liquidations in June 2022 – up from 132 in June 2021, and 135 in June 2020. The report further indicated that the industries most affected by liquidations were the financing, insurance, real estate, and business service sectors. August also brought about a new repo rate as the South African Reserve Bank hiked it 75 basis points to 5,5% per annum.

The provisional liquidator of Comair has confirmed that British Airways has cancelled its franchise agreement with Comair. British Airways is now considering and assessing potential new partners in the South African aviation market. In business rescue news, CNA's business rescue practitioner (BRP) has stated that the business rescue process for the entity will be shortly terminated. Despite the imminent termination of the business rescue proceedings, the BRP has stated that he is still of the belief that the process has resulted in a better outcome than what would have occurred through liquidation.

On the brighter side, spring brings warmer temperatures, and life seems more vibrant and willing to re-grow after the harshness of the colder winter months. Similarly, if you desire to assess your options to not only survive the current financial hardships but to also re-grow, revitalise and invigorate your entity, the CDH Business Rescue, Restructuring & Insolvency Sector is ready to assist and advise.

In this month's edition of the newsletter, we consider using South African business rescue provisions to argue for the recognition of foreign administration and curatorship orders in South Africa. We further discuss the unintended consequences of suspending winding-up proceedings pending the business rescue process.

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Using South African business rescue provisions to argue for the recognition of foreign administration or curatorship orders in South Africa

It is well known in the shipping/maritime sector that it is relatively uncomplicated to arrest foreign vessels when in South African territorial waters. Our admiralty jurisdiction laws are extremely plaintiff and creditor friendly. While there are obvious advantages to this, it has also proved to be a problem over the last two decades in the context of various economic global incidents causing havoc in the commercial shipping industry. Largely due to these global incidents, many shipping companies have been placed in administration or curatorship in various jurisdictions around the world. However, foreign administration or curatorship orders, and the protections afforded under them, are not automatically recognised in South Africa. Despite these orders, it is still possible to arrest a vessel owned by a shipping company under or in administration or curatorship in another country. This has, obviously, had a negative impact on the international commercial shipping industry. Hope was found, however, using South Africa's business rescue provisions.

Our intention with this article is to explore how foreign shipping administration or curatorship orders (or the like) can be made orders in South Africa using our business rescue procedure as a tool of persuasion. This is especially relevant in light of the Admiralty Jurisdiction Regulation Act 105 of 1983 (Act) which, being creditor-friendly, allows for the arrest of foreign vessels routing through South Africa. Until a foreign administration order is recognised by our courts, the protection afforded to a vessel under that order is defunct in South Africa.

Being under administration (or the like) generally means a hiatus on payments to creditors. Therefore, companies under administration are at high risk of having their vessels arrested in creditor-friendly jurisdictions where they are not protected by the administration order. This means that, until the foreign

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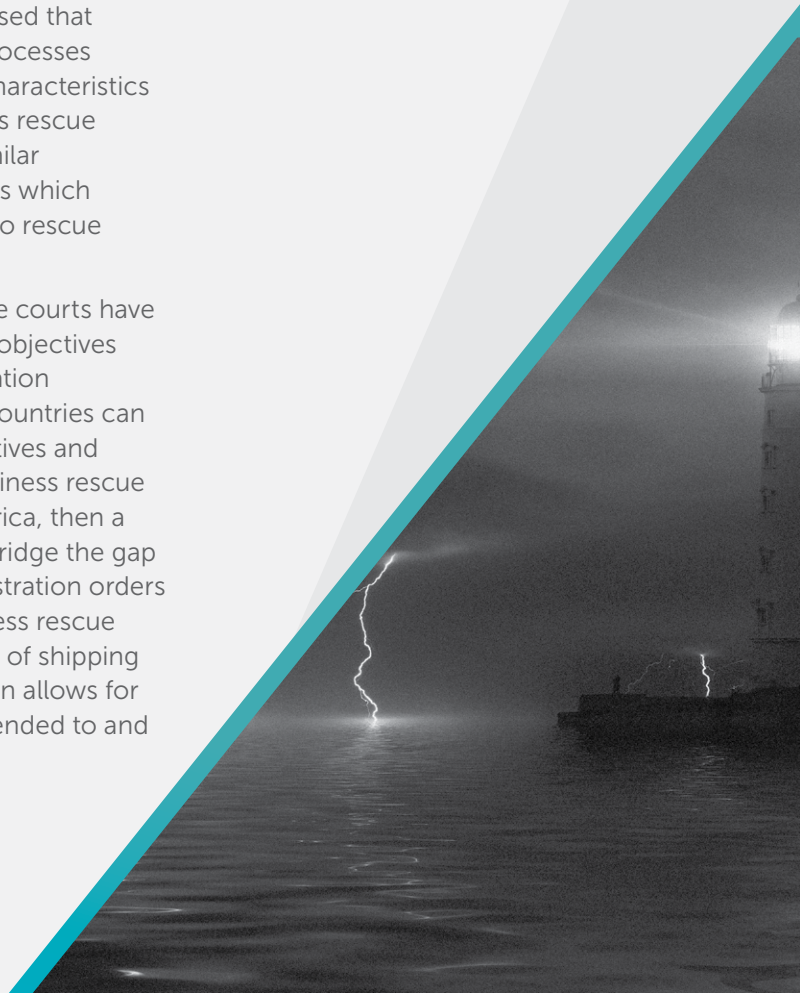
protection orders are recognised in South Africa, those entities currently undergoing foreign administration proceedings tend to avoid their vessels entering South African waters and ports unless absolutely necessary. Consequently, many companies face a dilemma and South Africa incurs a reduction of trade and co-operation, which in turn frustrates the growth of our shipping industry and economy in general.

As is well known (see our previous Business Rescue, Restructuring & Insolvency newsletters), South Africa's business rescue procedure can be used for a variety of positive outcomes for a company, which in turn can facilitate holistic economic growth for South Africa (and, as seen below, its international shipping trading partners).

The shipping industry is no exception. Over the years our CDH Business Rescue, Restructuring and Insolvency Team has successfully used South Africa's business rescue provisions to persuade our courts to recognise foreign administration orders in the shipping sector, thereby increasing the ambit of the protection to include South Africa.

The courts have recognised that foreign administrative processes usually contain similar characteristics to South Africa's business rescue process, and provide similar protection for companies which have the legitimate aim to rescue their business.

From our experience, the courts have made it clear that when objectives and effects of administration proceedings in foreign countries can be equated to the objectives and effects of and under business rescue proceedings in South Africa, then a court has little issue to bridge the gap between foreign administration orders and South African business rescue provisions in the context of shipping law. This recognition then allows for the protection to be extended to and in South Africa.



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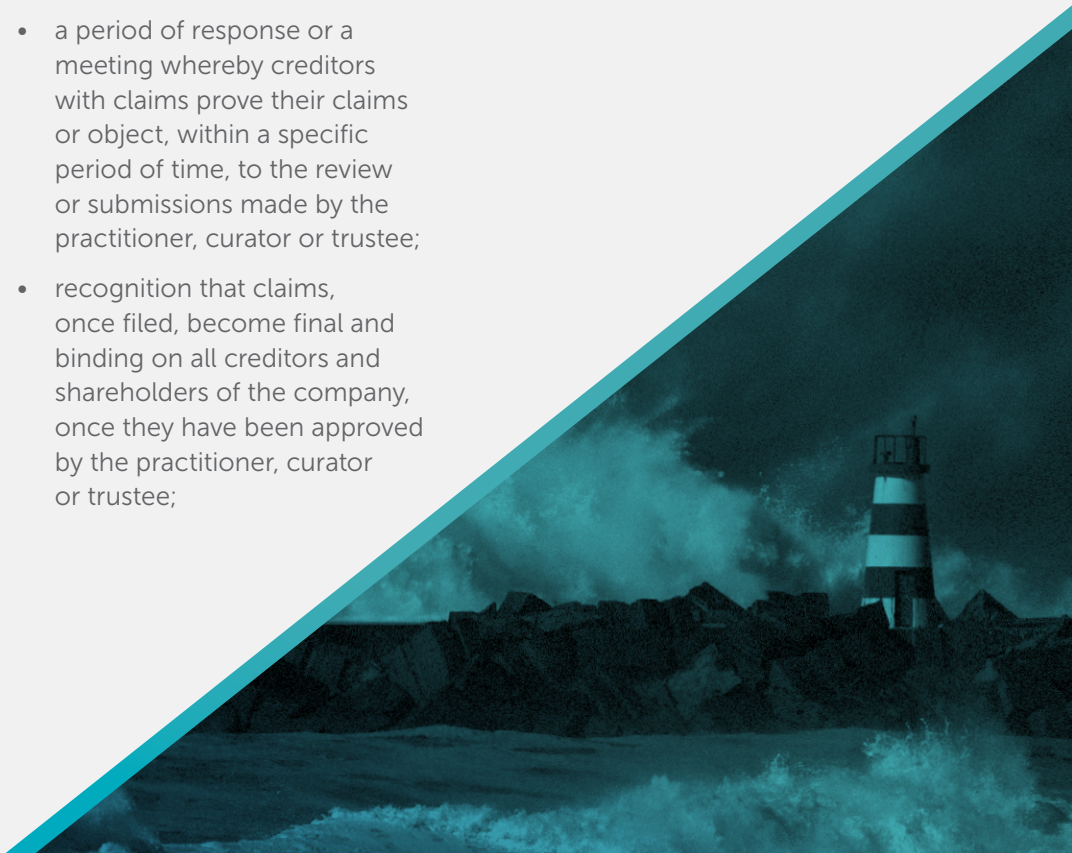
RECOGNISABLE CHARACTERISTICS

Some of these similar characteristics invariably include the following:

- The foreign administrative procedure commences because the company in question is unable to make payments when due without causing significant hindrance to the continuation of its business.
- To obtain an administration order, a legitimate foundation must be established that the business can be rescued and returned to profitability.
- The foreign administrative procedure usually involves:
    - an investigation into the assets and liabilities of the company;
    - a process whereby a company's creditors can submit (within a stipulated period of time) claims against the business in order for them to participate in the administration proceedings;
    - the appointment of a practitioner, curator or trustee to administer the business;
    - the review of creditor claims, by the practitioner, curator or trustee, whereby having to submit such review to an authoritative body or court for record purposes;
    - a period of response or a meeting whereby creditors with claims prove their claims or object, within a specific period of time, to the review or submissions made by the practitioner, curator or trustee;
    - recognition that claims, once filed, become final and binding on all creditors and shareholders of the company, once they have been approved by the practitioner, curator or trustee;
    - the preparation of an administration plan by the practitioner, curator or trustee within a set timeframe;
    - a mechanism whereby creditors or other parties with standing object or query the plan that is submitted by the practitioner, curator or trustee;



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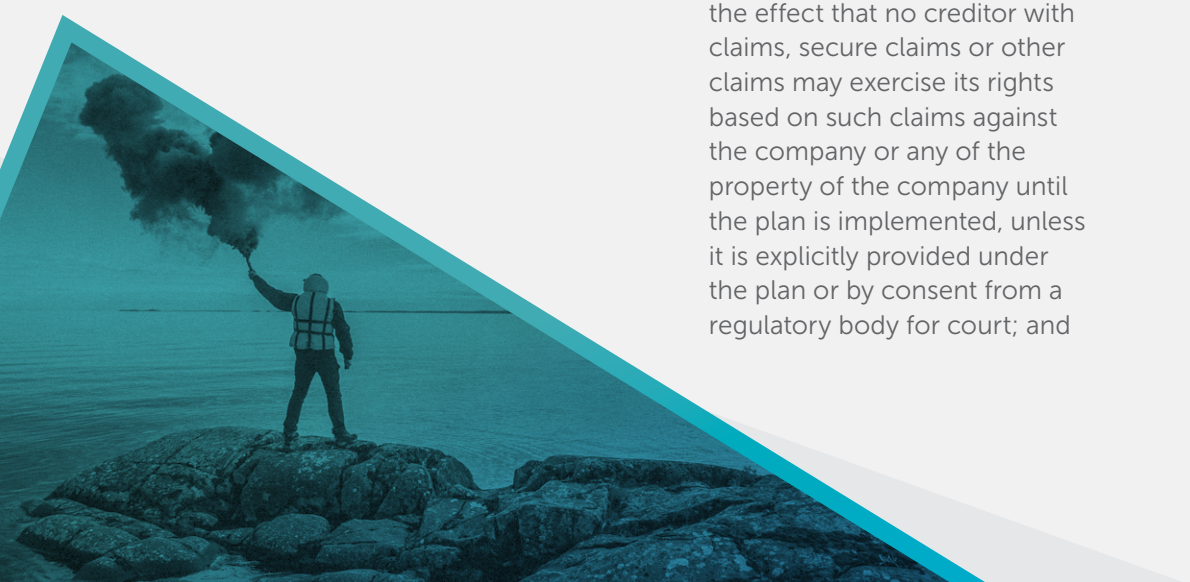

- confirmation by the relevant regulatory body or court, after the plan has been approved by the voters, to the effect that it is confirmed that the plan is:
  - viable;
  - its provisions are fair and equitable;
  - it has been approved by the voters in good faith; and
  - all conditions to the plan are satisfied.
- a moratorium or an order for commencement of the administration proceedings to the effect that no creditor with claims, secure claims or other claims may exercise its rights based on such claims against the company or any of the property of the company until the plan is implemented, unless it is explicitly provided under the plan or by consent from a regulatory body for court; and
- the administration proceedings terminating by decision of a regulatory body or court when the plan is implemented. Whereby satisfying the situation where the company is able to restructure 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.

SOUND FAMILIAR?

This application in the shipping industry is but an example of what can be achieved when comparing our unique business rescue procedure to similar procedures in other jurisdictions. We are of the view that, where necessary, recognition of foreign administrative orders in other sectors should not be any less successful.

This is not only for the greater good of the companies in question, but also promotes and establishes South Africa as forward thinking, allowing greater room for the rescuing of foreign businesses in distress, but capable of rescue. In turn this promotes the economy, public policy and continued establishment of the principles of the comity of nations, allowing for reciprocity of recognition of South African business rescue orders in other jurisdictions.

BELINDA SCRIBA AND JAMIE OLIVER

Kicking for touch: The unintended consequences of suspending winding-up proceedings pending business rescue

"Kicking for touch" is a phrase known by many in the world of sports. It is used loosely by sports players on the rugby field to describe a move to play away from a team's goal line to that of its opponent so as to gain a tactical advantage. It brings the game to life. In the context of insolvency, kicking for touch has become a misnomer used to describe a litigant seeking to use every trick in the book to delay the finalisation of court proceedings. In this context, section 131(6) of the Companies Act 71 of 2008 bears this out. The section makes provision for a fresh business rescue application to suspend the already ongoing winding-up of a company under financial distress, therefore delaying the inevitable liquidation of that company.

Kicking for touch: The unintended consequences of suspending winding-up proceedings pending business rescue

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Essentially, section 131(6) provides that, if liquidation proceedings have already been started by or against a financially distressed company, a subsequent business rescue application will automatically suspend those liquidation proceedings. But that suspension will only be until the court has adjudicated on the business rescue application; or until a court grants an order ending the business rescue proceedings.

In the recent judgment of *GCC Engineering (Pty) Ltd v Maroos* [2019] (2) SA 379 (SCA), the Supreme Court of Appeal (SCA) gave clarity to section 131(6). The court stated that an application for business rescue under section 131(6) only suspends the process of realising assets of the company in liquidation, and does not terminate the winding-up, whose ultimate aim is to distribute the proceeds to the various creditors. That means the winding-up order remains in place. The clarity provided by the SCA does not solve the problem, however. More so in instances where a business rescue application has been instituted in order to delay or frustrate the process of realising the company's assets for the benefit of creditors.

The intentions of business rescue are noble: it allows a company under financial distress some breathing space so as to enable it, amongst other things, to restructure its affairs in such a way that it can continue to trade on a solvent basis. However, section 131(6), which places business rescue right in the middle of a liquidation, causes the unintended consequence of delaying the inevitable liquidation of a company that is hopelessly insolvent.

In practice, this situation often arises when a creditor, who happens to be sympathetic to the insolvent company, colludes with its directors and institutes a business rescue application in the face of imminent winding-up proceedings, in order to proverbially "*kick for touch*". Often, a business rescue application is brought in order to avoid the appointed liquidators initiating an enquiry to investigate the financial affairs of the company prior to its demise, in an attempt to hold the directors accountable for their actions.

Typically, in order to succeed with an application for business rescue, an applicant is required to allege in its founding affidavit that there is a reasonable prospect that the company can be saved or that placing it in business rescue would facilitate a better return for creditors. In most cases, these applications fail to meet either threshold. Section 131(6) fails to provide a mechanism to discourage this abuse, and in many ways incentivises it.

Kicking for touch: The unintended consequences of suspending winding-up proceedings pending business rescue

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CAUTIONS AGAINST ABUSE OF BUSINESS RESCUE PROCEEDINGS

As an illustration, in the case of *Absa Bank Ltd v Newcity Group (Pty) Ltd* [2013] 3 All SA 146 (GSJ), Sutherland J considered a business rescue application instituted by the sole shareholder and director of Newcity. He concluded that the application was not genuine but simply a "*ruse*". He held that the business rescue application must be branded an abuse and refused the order by Newcity.

In the case of *Blue Star Holdings (Pty) Ltd v West Coast Oyster Growers CC* [2013] (6) SA 540 (WCC), Gamble J cautioned against the abuse of business rescue proceedings which are used "*by an obstructive debtor intent on avoiding the obviously inevitable as part of its ongoing strategy to hinder a creditor from pursuing its lawfully permissible goal*".

The rationale behind section 131(6) is sensible, which is to help financially-distressed companies with a genuine chance of rescue from the bleak prospect of liquidation. However, it would be prudent for the Legislature to impose a higher threshold on prospective business rescue applicants. This can be done by amending section 131(6) to replace the automatic suspension of the winding-up proceedings with a requirement that a case must first be made out in order to justify the suspension of the winding up. Such an amendment will mean that winding-up proceedings can only be suspended by an application for business rescue under section 131(6) with the express leave of the court.

MONGEZI MPAHLWA AND
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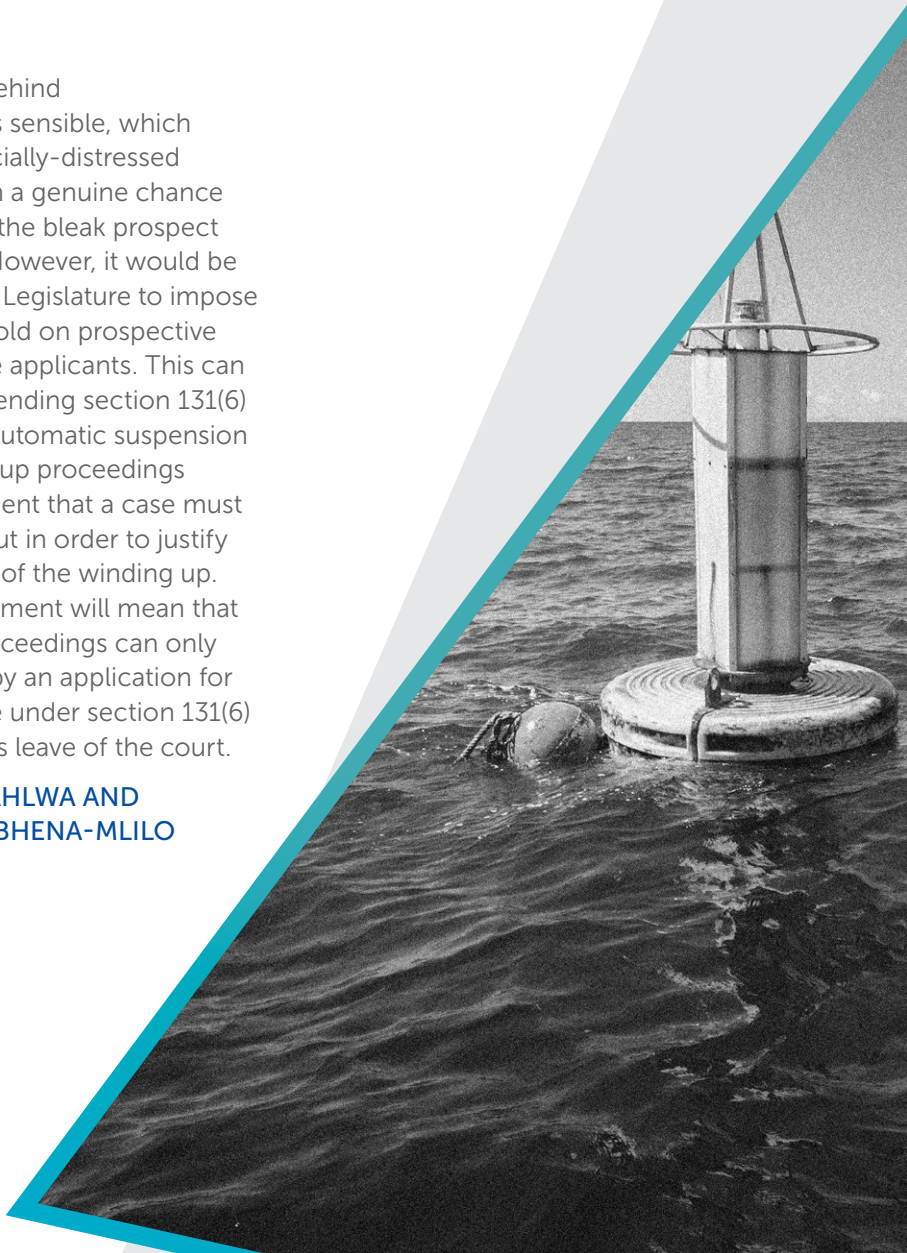

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BBBEE STATUS: LEVEL ONE CONTRIBUTOR
Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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