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Business Rescue, Restructuring & Insolvency

NEWSLETTER

DISPUTE RESOLUTION

CLIFFE DEKKER HOFMEYR

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We are now in the second month of 2023 and the festive season feels like a long time ago as we return to sending our 'kind regards', handling back-to-school stress, and settling back into our daily routines. While a new year is synonymous with new opportunities, South Africa is still faced with the same challenges it faced in 2022 and years gone by.

Loadshedding is still a reality that we have unfortunately become far too familiar with. The energy crisis has led to our country facing an unprecedented height of power outages, affecting food security, mobile networks and the business and industries sectors at large. It is undeniable that loadshedding has touched the lives of every South African in rather severe ways, from hundreds of small home-grown businesses having to close their doors due to increased operational costs, to even multinational companies feeling the pinch as fast-food chains have had to reduce menu options and even closed down some of their outlets in South Africa due to the impact of loadshedding on suppliers. It is therefore not hard to imagine that the impact of loadshedding will lead to increased business proceedings and liquidation proceedings. In fact, recent data shows that the number of liquidations surged by 30,3% by December 2022. A recent Stats SA publication notes that the bulk of the liquidations have been voluntary, showing a trend that companies do not believe their financial distress will change.

In contrast to this, however, ABSA Bank's recently released Purchasing Managers' Index demonstrates that business activity in South Africa has improved in January 2023, in spite of non-stop loadshedding. Further to this, tourism picked up strongly over the December holiday period with two million foreign travellers passing through South Africa's borders, thereby strengthening our economy.

In some insolvency news, South Africa's largest producer of sugar, Tongaat Hulett entered into business rescue in October 2022 and has recently received an undisclosed sum of money as working capital from the Industrial Development Corporation. The capital will be used

to ensure that the current season is completed and to carry out off-crop maintenance. This cash injection will certainly aid the company with the short-term survival of its operations and will also assist the thousands of livelihoods that the company supports.

In this month's edition, Director Belinda Scriba and associate Paige Winfield consider the Supreme Court of Canada's recent assessment of the clash between arbitration and insolvency law when Ernst & Young, in its capacity as the appointed receiver and manager over a company placed under receivership, had issued court papers in a civil claim for debt recovery on behalf of the company, notwithstanding the existence of arbitral dispute resolution clauses in the contracts entered into between the company and the alleged debtor. Partner Desmond Odhiambo and associate Daniel Munsiro from our Kenyan team consider administration as a mechanism for reviving stalled real estate projects within Kenya.

Perhaps it is too late to wish everyone compliments of the new year, however despite already being in February, the CDH Business Rescue, Restructuring & Insolvency Sector would like to wish our clients and readers a prosperous year ahead; and we look forward to continuing to assist with navigating the commercial obstacles that are ahead in 2023.

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SOUTH AFRICA

"Should I stay or should I go now?"– Enforceability of arbitration clauses/ agreements in liquidation scenarios

The Supreme Court of Canada recently examined the clash between arbitration and insolvency law when Ernst & Young (EY), in its capacity as the appointed receiver and manager over a company placed under receivership, issued court papers in a civil claim for debt recovery on behalf of the company, notwithstanding the existence of arbitral dispute resolution clauses in the contracts entered into between the company and the alleged debtor.

Peace River Hydro Partners (Peace River) subcontracted work to Petrowest Corporation (Petrowest) and its affiliates to build a hydroelectric dam in North-eastern British Columbia. Petrowest then faced financial trouble and was placed under receivership in terms of section 243(1) of the Canadian Bankruptcy and Insolvency Act, R.S.C., 1985 (BIA), which is comparable to a company being placed in liquidation in terms of the Companies Act 71 of 2008 in South Africa.

EY (the receiver), following its duty to ensure that Petrowest's receivership was resolved efficiently and in the best interests of its creditors, instituted a civil claim in the Alberta Court of Queen's Bench against Peace River for the collection of funds it allegedly owed to Petrowest and its affiliates for subcontracted work.

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However, the contracts that Peace River and Petrowest had concluded all provided that disputes between the parties should be resolved through arbitration. Accordingly, upon the receipt of the receiver's civil claim, Peace River launched an application for a stay of proceedings in terms of section 15 of the Arbitration Act, R.S.B.C., 1996 (Arbitration Act), on the grounds that the arbitral clauses in the parties' various agreements obliged the receiver to have instead initiated the recovery proceedings in terms of the contractual arbitration clauses.

Canadian courts' findings

The receiver opposed the stay application. It argued that the BIA authorised the court to assert centralised jurisdiction control over the matter rather than to send the receiver to multiple arbitral forums. This would allow, according to EY, a more efficient and orderly resolution of the receivership. The court of first instance dismissed Peace River's application, as did the Appeal Court. Peace River appealed to the Supreme Court of Canada. The Supreme Court too found in favour of the receiver, ruling that the receiver should be allowed to proceed with its recovery claim through court proceedings and agreed not to stay the proceedings.

Notwithstanding the final outcome in this instance, the Supreme Court did hold that on a proper interpretation of section 15 of the Arbitration Act, a receiver could not simply avoid an arbitration agreement, as allowing a receiver to do so was inconsistent with the principles of contract law, party autonomy, and the court's longstanding jurisprudence with respect to arbitration.

However, section 15(2) of the Arbitration Act requires a court to order the stay of legal proceedings if it finds an arbitration agreement is *"void, inoperative or incapable of being performed"*. On a balance of probabilities, the Supreme Court held that an otherwise valid arbitration agreement should be declared inoperative or incapable of being performed if those proceedings precluded the orderly and efficient resolution of the receivership.

The Supreme Court was explicit in cautioning that it is not a given that insolvency law will always stay and that arbitration law must go. In future, courts should consider this carefully and weigh up:

- the effect of arbitration on the integrity of insolvency proceedings (which are by their very nature intended to minimise prejudice to creditors);
- the relative prejudice to the parties to the arbitral agreement and the debtor's stakeholders;
- the urgency of resolving the dispute;

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"Should I stay or should I go now?"– Enforceability of arbitration clauses/ agreements in liquidation scenarios

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- the effect of the stay of proceedings arising from bankruptcy or insolvency proceedings; and
- any other material factors.

In other words, insolvency and receivership do not automatically exclude a receiver's obligation to have a dispute resolved by contractually agreed arbitration proceedings.

Position in South Africa

Although our arbitration and insolvency legislation does not deal with a possible conflict between the two areas of law, it is likely that a South African court could come to a conclusion similar to that of the Canadian Supreme Court.

Section 5 of the South African Arbitration Act 42 of 1965 (South African Arbitration Act), provides that *"unless the agreement otherwise provides, an arbitration agreement ... shall not be terminated by the winding-up of the corporate body"*. Thereby confirming that the arbitral agreement is still alive and cannot be discarded by a liquidator just because they were not a direct *"party"* to the agreement.

However, subsection 3(2) of the South African Arbitration Act states that a *"court may at any time on the application of any party to an arbitration agreement, on good cause shown:*

- *set aside the arbitration agreement; or*
- *order that any particular dispute referred to in the arbitration agreement shall not be referred to arbitration; or*
- *order that the arbitration agreement shall cease to have effect with reference to any dispute referred."*

Setting aside arbitration on good cause

In context, arbitration agreements are not automatically terminated as a result of the liquidation of a company and while the court has the discretion to, inter alia, set aside the arbitration agreement, it may only do so on good cause.

In *De Lange v Presiding Bishop of the Methodist Church of Southern Africa for the Time Being and Another* [2016] (1) BCLR 1 (CC) the Constitutional Court held that *"good cause"* only allows a court to set aside an arbitration agreement where a persuasive case has been made to do so. The court further held that it would not be ideal to define what precise circumstances would amount to being a persuasive case. It was reiterated that courts should be scrupulous when deliberating about whether to set aside arbitration

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"Should I stay or should I go now?"– Enforceability of arbitration clauses/ agreements in liquidation scenarios

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agreements unless there was a compelling reason to do so. The goals of arbitration should be upheld unless good cause required otherwise.

This instils the position taken by the South African Supreme Court of Appeal in the case of *Brisley v Drotsky* [2002] (4) SA 1 (SCA). The court found that party autonomy must be respected, and only special circumstances should exist to deviate from the parties' choice to resolve matters through the arbitration process. A compelling case must be made by the party seeking to diverge from the arbitration cause before a court will allow such divergence.

Therefore, for a liquidator to ignore an arbitration clause in a contractual dispute they would need to provide compelling reasons for not abiding by such clauses.

Most efficient route to resolving dispute in liquidation scenario

In the Canadian case there were numerous applicable arbitration clauses which, if enforced, would unduly complicate the dispute resolution process. As the purpose of receivership is to resolve matters as quickly as possibly for the best outcome of creditors, the court found that the complications created by the arbitration clauses made the clauses, in the circumstances, inoperative.

Whether a South African court may have reached a similar conclusion is dependent on the circumstances, in a South African context, and would involve weighing up the nature of the proceedings instituted (action or application) against the complications in the implementation of the arbitration clauses, and likelihood of the matter being resolved through the courts faster than through complicated arbitration proceedings.

It is clear from the South African cases mentioned above that compelling reasons need to be shown for the courts to look past the arbitration clauses. This is no different in a liquidation scenario.

South Africa looks to other common law jurisdictions, such as Canada, for comparative case law and emerging legal precedent that might find application upon our shores. If the underlying dictum of this case is anything to go by, it is that expediency and efficiency will be key elements in deciding whether or not a court will set aside a valid and otherwise binding arbitration clause and that the timeous resolution of liquidation processes is paramount. These principles are generally universal in terms of insolvency proceedings, and the Supreme Court in Canada echoed this in its decision.

Belinda Scriba and Paige Winfield

KENYA

Administration as a mechanism for reviving stalled real estate projects

In recent months, the media has been pervaded by news of real estate companies sinking with billions of investors' funds. The default action by most investors is to sue the companies for breach of contract, but they end up with paper judgments that they cannot enforce. What alternatives are available to these investors?

Stalled real estate projects grapple with cash flow challenges due to poor forecasting or failure to take corrective action when the actual expenditure does not match the budgeted expenditure. They also grapple with a high debt to equity ratio when a large proportion of the capital comes from creditors (investors that bought off plan) instead of capital from the company's owners. This makes it difficult to obtain additional financing to complete the project.

The appointment of an administrator by either the company or the creditors as soon as these signs of financial distress appear may mitigate further losses. The first task of the administrator would be to ascertain whether the distressed company is viable. If it is viable they would make recommendations of how the stalled project may be revived. These

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Administration as a mechanism for reviving stalled real estate projects

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would be captured in a report that would be made available to the creditors so that they know how to support the company. Some of the strategies that an administrator may use include:

1. *Debt restructuring to tackle cash flow shortages*

In cases where the insolvent company is grappling with cash flow challenges, the administrator may negotiate a long-term payment plan with suppliers that may include trimming part of the debt. This will ensure that cash flowing out of the company is delayed or reduced, which helps minimise the strain on the company's working capital.

The administrator may also negotiate for alteration of interest rates and forbearance of penalties on loan agreements.

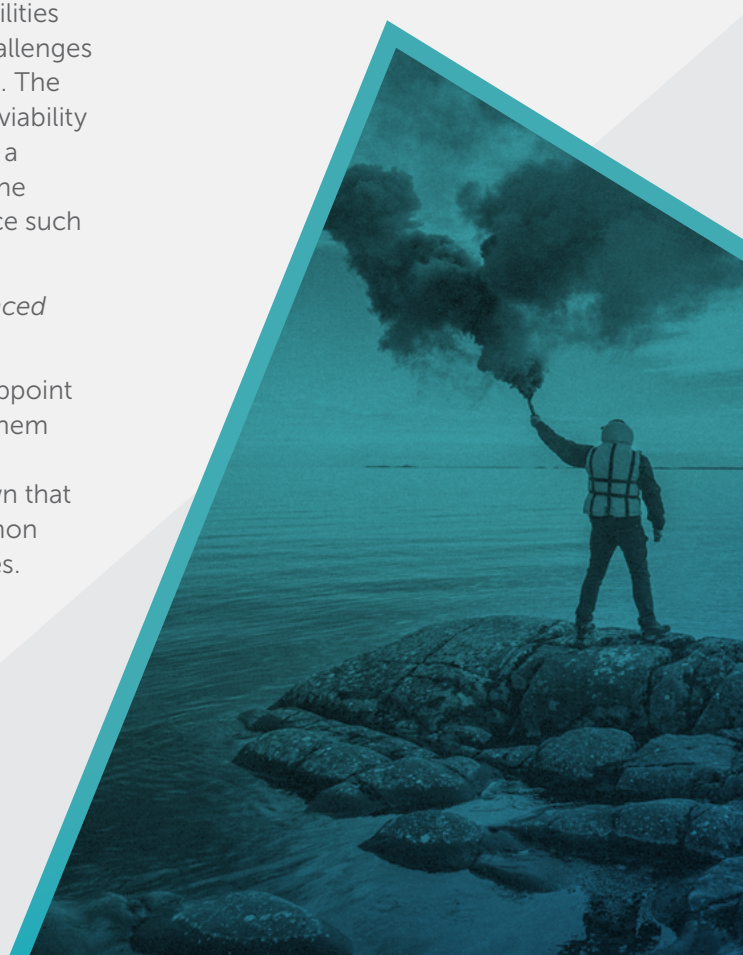
2. *Source for turnaround finance*

Emergency or turnaround finance relates to financing that is advanced to an insolvent but viable company by financial institutions. This additional finance provides the company with a cash injection to pay its liabilities and resolve any cash flow challenges that the company might have. The administrator's report on the viability of the business together with a turnaround plan would give the lenders confidence to advance such facilities.

3. *Appointment of experienced managers*

The administrator may also appoint experienced people to help them steer the management of the company. Reports have shown that poor management is a common factor in distressed companies.

The infusion of experienced management into the company will help the administrator deliver on the creditors' expectations.



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Administration as a mechanism for reviving stalled real estate projects

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4. *Collaboration with established market leaders*

Besides the strategies highlighted above, the administrator may also partner with established market leaders. These partnerships may help revive the company as it leverages economies of scale and access to resources. Additionally, such collaborations offer the company a much needed reputational boost.

How investors in stalled real estate projects may initiate the administration

Creditors, such as investors in the real estate project, may apply to court for the appointment of an administrator. To this end, the investors would need to come together as a unit and file an application seeking an administration order over the company.

Once the application is filed, the court will assess the merits of the application and consider whether the real estate company is insolvent.

Conclusion

Administration of distressed real estate companies offers an opportunity for stalled development projects to be revived if there is timely intervention. Investors are encouraged to watch out for early signs of financial distress so that they can mitigate their losses.

Desmond Odhiambo and
Daniel Munsiro

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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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