

NEWSLETTER

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The long-awaited first batch of COVID-19 vaccines arrived on South African shores this week, however, for those not in the frontline, it may feel like a bit of a pie in the sky victory for SA as there is no real indication as to when the rest of SA will receive the jab which will allow life to go back to normal.

With 2021 presenting new opportunities and hope for a better life than what was experienced in 2020, 2021 did not come without its challenges right from the get-go. Dry January seemed to be a trend adopted by far more people in 2021 than in previous years – although it might not have been voluntary adopted this time around; and South Africans started returning to work without having experienced the ‘beach break’ that they had envisioned over December or traditionally looked forward to in previous years.

All in all, it isn't really a “New Year” as we are still faced with the same challenges that spilled over from 2020, however, we may now be slightly more equipped and less expectant of the norm, as we start to settle into our home offices and Teams/Zoom meetings for another year of remote working.

On the Insolvency and Business Rescue front, we have seen that since last year's SAA v NUMSA judgment wherein the Labour Court and Labour Appeal Court upheld a moratorium on retrenchments of employees during SAA's business rescue proceedings until such time as the Business Rescue Plan had been implemented, NUMSA has now once again approached the Labour Court for further relief for its members.

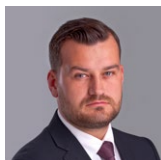
NUMSA, together with the South African Cabin Crew Association (SACCA), has approached the Labour Court in an effort to compel SAA to pay three months' deferred salaries, a lump sum of the agreed 5.9% increase backdated to April 2020, and the equivalent of a pro-rata contribution towards a 13th cheque to their members. An offer for the equivalent was struck with other unions at the airline in December, however, NUMSA and SACCA declined the offer at the time.

We will be keeping a close eye on the outcome of this matter, which could potentially further impact employees' rights in a business rescue setting.

In this edition of the newsletter, we consider whether set-off can be applied during business rescue proceedings. This is a question that various companies and business rescue practitioners will need to consider, if they haven't done so already. We hope that this newsletter sheds some light on this interesting legal question.

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Can you apply set-off during business rescue?



In light of the current tough economic climate in South Africa, this is a question that various companies and business rescue practitioners will be asking.

What is set-off?

In the case of *Schierhout Appellant v Union Government* (Minister of Justice) Respondent 1926 AD 286, Innes CJ, as he then was, described the doctrine of set-off as follows:

"The doctrine of set-off with us is not derived from statute and regulated by rule of court, as in England. It is a recognised principle of our common law. When two parties are mutually indebted to each other, both debts being liquidated and fully due, then the doctrine of compensation comes into operation. The one debt extinguishes the other pro tanto as effectually as if payment had been made. Should one of the creditors seek thereafter to enforce his claim, the defendant would have to set up the defence of compensation by bringing the facts to the notice of the Court --- as indeed the defence of payment would also have to be pleaded and proved. But, compensation once established, the claim would be regarded as extinguished from the moment the mutual debts were in existence together."

Although the South African institutional writers and our courts were previously uncertain as to whether set-off takes place (i) automatically and *ipso iure* once reciprocal debts exist in a form that admits of set-off; or (ii) not *ipso iure*, but only if two debts co-exist and one of the debtors invokes set-off, it appears as if the overwhelming weight of authority is to the effect that set-off occurs automatically when reciprocal debts arise.

Can you apply set-off during business rescue?....continued



The requirements for set-off to take place are the following:

- (i) The debts must be owing between the same parties in the same capacities;
- (ii) The debts must be of the same kind;
- (iii) The reciprocal debts must be due and enforceable; and
- (iv) The debts must be liquidated in the sense that they are capable of speedy and easy proof.

Even though set-off forms part of the South African common law, it can also be regulated *inter partes* in terms of a contract. For instance, a contract can expressly state that set-off will, or will not, apply between the parties to that contract.

The effect of the statutory moratorium on set-off

Section 133 of the Companies Act states 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, *inter alia*:

- (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; or
- (c) as a set-off against any claim made by the company in any legal proceedings, irrespective of whether those proceedings commenced before or after the business rescue proceedings began.

Can set-off be considered "enforcement action"?

In light of the judgment in the case of *Cloete Murray & another NNO v First Rand Bank 2015 (3) SA 438 (SCA)*, where the SCA noted that the inclusion of the term "enforcement action" under the generic phrase "legal proceeding" in section 133(1) of the Companies Act, is an indication that "enforcement action" is considered to be a species of "legal proceeding" or, at least, is meant to have its origin in legal proceedings, it is unlikely that parties will be able to successfully argue that set-off constitutes "enforcement action".

Can set-off only be applied if the company under business rescue institutes "legal proceedings"?

Since section 133(1)(c) of the Companies Act specifically states that set-off may be applied against any claim made by the company under business rescue in any legal proceedings, it could be argued that once a company is under business rescue, set-off cannot be applied under any circumstances outside of the narrow parameters of section 133(1)(c) of the Companies Act. In other words, set-off can only be applied if the company under business rescue institutes legal proceedings against a debtor.

It is generally accepted that if the legislature had a specific intention, it would be reflected in the clear and unambiguous words of the text. Section 133(1)(c) of the Companies Act only provides a defendant with a defence in response to a claim by the company for payment of a debt. As such it will be difficult to successfully argue that it was the intention of the legislature to limit the operation of set-off during business rescue by way of section 133(1)(c) of the Companies Act.

Considering all the above, we are of the view that the moratorium in terms of section 133(1) of the Companies Act does not affect the operation of set-off.

Can you apply set-off during business rescue?....continued



The effect of section 154(2) of the Companies Act on set-off

Section 154(2) of the Companies Act states that if a business rescue plan has been approved and implemented in accordance with Chapter 6 of the Companies Act, a creditor is not entitled to enforce any debt owed by the company immediately before the beginning of the business rescue process, except to the extent provided for in the business rescue plan.

In light of section 154(2) of the Companies Act, it could be argued that since the pre-commencement debts owing by the company under business rescue are not enforceable, except to the extent provided for in the business rescue plan, one of the requirements for set-off to take place would not be met, and as such, set-off would not be able to take place.

Natural obligations are the exception to the rule that set-off can only operate if the debts are due and enforceable. Set-off can still be applied to debts arising from natural obligations, even though those debts are not enforceable. A natural obligation establishes a legal bond but is imperfect, in the sense that it does not give rise to an action. Although a natural obligation gives no right of action, it has some value, since it can be pleaded as an exception, for example, as an answer to a *condictio indebiti*.

In our view, if debts are unenforceable as a result of an adopted business rescue plan, it could be argued that the debts constitute natural obligations, and as such, set-off will still take place *ipso iure*.

Our abovementioned view is supported by the fact that the legislature expressly included the defence of set-off in section 133(1)(c) of the Companies Act.

Conclusion

The operation of set-off during business rescue proceedings have not been considered by the South African courts as yet. As such, it remains uncertain at this stage how the courts will view the effect of business rescue proceedings on set-off.

Based on the reasons set out above, we are of the view that set-off will continue to take place *ipso iure*, even if one of the parties are under business rescue.

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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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