19 JANUARY 2021

DISPUTE RESOLUTION **ALERT**

IN THIS **ISSUE**

CDH
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Is South African business rescue available to external companies?

The SCA had to determine whether a for-profit company, incorporated in a country other than South Africa, could take advantage of the business rescue provisions of the Companies Act 71 of 2008.

An "*external company*" is defined in the Companies Act 71 of 2008 (Act) as "*a foreign company that is carrying on business, or non-profit activities, ... within [South Africa]*". Considering that such companies are actively participating in our economy, it is reasonable to ask whether these companies should qualify for the protection afforded by our business rescue laws.

This question was recently placed before the Supreme Court of Appeal (SCA), in the matter of *Cooperativa Muratori Cementisti - CMC Di Ravenna and Others v Companies and Intellectual Property Commission* [2020] ZASCA 151. The SCA had to determine whether a for-profit company, incorporated in a country other than South Africa, could take advantage of the business rescue provisions of the Act.

The appellant, Cooperativa Muratori & Cementisti – CMC Di Ravenna Societá Cooperativa a Responsibilita Limitata (CMC) is an international construction company incorporated in Italy, which is registered in South Africa as an external company in terms of the Act.

Towards the end of 2018, CMC began to experience financial difficulties. It approached the Bankruptcy Section of the Court of Ravenna, with a preventative application for admission to the procedure for the arrangement with creditors subject to Italian Bankruptcy Law. The Court of Ravenna issued an Order providing CMC with sixty days within which to, *inter alia*, file a proposal for composition with its creditors and to be subjected to strict judicial oversight.

Unsatisfied with the Court of Ravenna's Order, the directors of CMC resolved that the company, in financial distress, be placed under business rescue in South Africa in terms of section 129(1) of the Act. Business rescue practitioners (BRPs) were nominated in the process.

The Companies and Intellectual Property Commission (CIPC) advised the business rescue practitioners that, as an external company, CMC could not be placed into business rescue. The BRPs applied to the Gauteng High Court, Pretoria seeking an, amongst other relief, an order declaring that CMC was under business rescue supervision in terms of the Act.

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Is South African business rescue available to external companies?

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The Act clearly states that business rescue is only available to a company. Therefore, for CMC to be eligible for business rescue in South Africa, it would need to meet the definition of a company.

Potterill J, presiding over the matter in the High Court, dismissed the application. The BRP's consequently brought an appeal before the SCA.

In reaching its decision, the SCA obviously turned to the wording as contained in the business rescue provisions of the Act.

The Act clearly states that business rescue is only available to a company. Therefore, for CMC to be eligible for business rescue in South Africa, it would need to meet the definition of a company.

A "*company*" is defined in section 1 of the Act as follows:

> *"A juristic person incorporated in terms of this Act, a domesticated company, or ajuristic person that, immediately before the effective date –*
>
> *(a) was registered in terms of the –*
>
> *(i) Companies Act 1973, other than as an external company as defined in that Act; or*
>
> *(ii) Close Corporations Act 1984, if it has subsequently been converted in terms of Schedule 2;*
>
> *(b) was in existence and recognised as an 'existing company' in terms of the Companies Act 1973; or*
>
> *(c) was deregistered in terms of the Companies Act 1973, and has subsequently been re-registered in terms of this Act."*

In argument, counsel for CMC admitted that CMC is not a company in terms of any of the aforestated sub-sections of the definition. Even though the company was registered in South Africa as an external company in terms of the Companies Act 61 of 1973 (Old Act), subsection (a) above expressly excludes an external company registered under the Old Act. Neither was CMC ever a close corporation. A company existed and was recognised under the Old Act if it existed and was recognised in terms of the 1926 Companies Act 46 of 1926. This provision did not apply to CMC either, therefore excluding it from qualifying under sub-section (b). CMC was not deregistered under the Old Act and so it does not qualify as a company under sub-section (c).

The question was then, whether CMC fell within the Act's definition of *"a juristic person incorporated in terms of the Act"*.

A '*foreign company*' under section 1 of the Act means 'an entity incorporated outside the Republic' irrespective of whether it is a profit or non-profit entity, or carrying on business or non-profit activities within the Republic. The definition of 'juristic person' therefore includes a foreign company and the definition of an 'external company'.

However, the court went on to compare processes under section 13(1) of the Act with section 23. The former deals with the incorporation of South African companies, where the latter deals with the registration of foreign companies.

Is South African business rescue available to external companies?

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As the definition of *"company"* prescribes that it be both (i) a juristic person; and (ii) incorporated in terms of the Act, foreign (external) companies falls outside the definition of *"company"* as required by the business rescue provisions.

As the definition of *"company"* prescribes that it be both (i) a juristic person; and (ii) incorporated in terms of the Act, foreign (external) companies falls outside the definition of *"company"* as required by the business rescue provisions.

Therefore, as an external company is not a *"company"* for purposes of the Act, it is thereby precluded from applying for, or being placed under, business rescue.

The above decision notwithstanding, there are other remedies available to foreign companies, whether they are registered as external companies or not. These remedies include applying for recognition in South Africa of foreign bankruptcy proceedings. This was an alternative remedy sought by CMC's BRPs. However, the BRPs were also unsuccessful in obtaining this relief. A follow-up article shall be published outlining the reasons for the failure in obtaining the relief sought, and how to avoid a repeat thereof.

Belinda Scriba and Andrew MacPherson

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Call for Public Comment: Expropriation Bill, Bill 23 of 2020

This engagement process presents a vital opportunity for interested parties to have their voices heard and concerns considered by the appropriate legislative bodies.

Public participation is a well-established and critical process in South Africa's legislative process. On Wednesday 2 December 2020, the Portfolio Committee on Public Works and Infrastructure officially invited stakeholders and interested parties to submit written submissions on the Expropriation Bill [B23 - 2020]. Written submissions are to be submitted to expropriationbill@parliament.gov.za by no later than Wednesday, 10 February 2021.

As indicated in our Webinar held on 12 November 2020, the Expropriation Bill undertakes a significant mandate in an effort to achieve its goals of redress and equality in South Africa. With this being said, the importance of public comment to this Bill cannot be underrated.

This engagement process presents a vital opportunity for interested parties to have their voices heard and concerns considered by the appropriate legislative bodies. Furthermore, this engagement presents a dual purpose of facilitating equitable land reform while protecting property rights. The need for public participation is of particular importance given the legal, political and historical treatment of the Bill.

Presently, the Bill requires attention if it is to achieve its intended purpose and thus the call for public comment is of utmost importance. By way of high level summary and by no means an exhaustive list, the following areas are required to be addressed prior to the Bill's enactment in order to allow for the proper implementation of the nation's commitment to land reform, without infringing on an individual's Constitutional rights:

1) Section 12(3) of the Bill sets out the listed circumstances under which land can be expropriated for nil compensation. There are many aspects of this section that need to be addressed in order to provide clarity and certainty and to avoid the arbitrary deprivation of citizen's right to property. The use of the words "*including, but not limited to*" is unacceptable and should be deleted. This phrase opens the flood gates to a plethora of bases on which land can be expropriated and can lead to abuse.
2) One area requiring clear attention is the absence of the process of due service of relevant notices to property owners residing in foreign jurisdictions. This presents clear practical and substantive limitations of the Bill.
3) The Bill leaves further uncertainty regarding the impact on financial institutions, particularly in their role as the mortgagee to a property intended to be expropriated. While section 18 of the Bill attempts to provide direction regarding a property to be expropriated which is subject to a mortgage – the Bill leaves much to be desired regarding the position of mortgagees.

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Call for Public Comment: Expropriation Bill, Bill 23 of 2020

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Should you require any further details regarding the process and substance of such submissions, please contact us for more information.

What we would like to see is a clear definition of a financial institution as a right holder insofar as the encumbered property is concerned. Due consultation should be held with the financial institutions as mortgagees during the process of expropriation - whilst currently there is no clear obligation on the expropriating authority to engage with financial institutions as mortgagees prior to the contemplation of compensation for the property to be expropriated.

Another related aspect that is required to be addressed is the date on which a bond is to be cancelled once expropriation occurs, and the practical considerations relating to the bond cancellation in the Deeds Office and the termination of the obligations to a mortgagee in this regard.

4) According to the present Bill, ownership of the expropriated property vests in the State, or the person on whose behalf the State caused such expropriation, on the date recorded in the notice of expropriation. In the result, transfer of ownership according to the current version of the Bill passes prior to registration in the Deeds Office.

This raises many substantive, legal and practical concerns (specifically taking into account the Alienation of Land Act and Deeds Registries Act) and as such is required to be dealt with should the Bill meet its objectives whilst escaping undue technical hurdles.

Whilst the Bill attempts to protect individuals' Constitutional rights while implementing its objectives in historical redress, there are areas within the Bill which have glaring issues and will ultimately be problematic should consideration not be had to these issues.

Should you require any further details regarding the process and substance of such submissions, please contact us for more information.

Claudette Dutilleux and Jonathan Sive

CLIFFE DEKKER HOFMEYR

When does a surety's right of recourse arise and what effect does section 154(2) of the Companies Act 71 of 2008 have on this right?

In the Zungu-Elgin Case, three sureties paid to a creditor the indebtedness owing by the principal debtor, after the creditor had exercised its rights in terms of the suretyship agreements and obtained judgment against the sureties (jointly and severally) for the indebtedness owing.

These are two of the questions that the Supreme Court of Appeal (SCA) had to consider in the recent case of *Zungu-Elgin Engineering (Pty) Ltd v Jeany Industrial Holdings (Pty) Ltd and Others* (1138/2019) [2020] ZASCA 160 (3 December 2020) (Zungu-Elgin Case).

Case discussion

In the Zungu-Elgin Case, three sureties paid to a creditor the indebtedness owing by the principal debtor, after the creditor had exercised its rights in terms of the suretyship agreements and obtained judgment against the sureties (jointly and severally) for the indebtedness owing. The sureties thereafter attempted to exercise their right of recourse against the principal debtor, by suing the principal debtor for the total amount that the sureties paid to the principal debtor's creditor. The principal debtor defended the action proceedings. The sureties consequently applied for summary judgment against the principal debtor, which proceedings the principal debtor opposed on the following basis:

1. It argued that it was placed under business rescue and that the debt to its creditor arose (and accordingly the sureties' right of recourse arose) prior to the commencement date of its business rescue. The principal debtor argued that, since the approved and implemented business rescue plan did not provide for this debt, the sureties were not entitled to enforce it; and
2. It contended that to permit claims against a company that were not provided for in the approved and implemented business rescue plan, might jeopardise the business rescue process.

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When does a surety's right of recourse arise and what effect does section 154(2) of the Companies Act 71 of 2008 have on this right?

...continued

The *court a quo* granted summary judgment against the principal debtor and granted the principal debtor leave to appeal its judgment.

It is important to mention at this juncture that the sureties only paid the principal debtor's creditor after the commencement of the business rescue proceedings. Despite this, the principal debtor argued that the sureties' right to recourse arose on an earlier date, when the principal debtor's debt arose.

The *court a quo* granted summary judgment against the principal debtor and granted the principal debtor leave to appeal its judgment.

In its judgment, the SCA first considered what is stated in section 154(2) of the Companies Act 71 of 2008 (Companies Act), which deals with the discharge of debts and claims against a company in business rescue. Section 154(2) states:

> *"If a business rescue plan has been approved and implemented in accordance with this Chapter, 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."*

The SCA thereafter highlighted the following well-known common law principles relating to a surety's right of recourse:

1. A surety who has paid the debt owed by the principal debtor to the creditor, has a right of recourse against the principal debtor. The surety is entitled to reimbursement by the principal debtor of what he/she has paid to the principal debtor's creditor; and
2. A surety can only be regarded as a creditor of the principal debtor, when the surety has paid the principal debtor's creditor.

The SCA thereafter held that the principal debtor's arguments were bad in law for the following reasons:

1. Section 154(2) of the Companies Act does not expressly or by necessary implication vary the common law principle that a debt based on the surety's right of recourse arises upon payment to the creditor.
2. On the contrary, in terms of section 154(2), the question whether any debt was owed by the company at the specified point in time, is to be determined in terms of existing law, including the common law.

The SCA accordingly dismissed the principal debtor's appeal.

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When does a surety's right of recourse arise and what effect does section 154(2) of the Companies Act 71 of 2008 have on this right?

...continued

The judgment makes it clear that a surety's right of recourse arises against the principal debtor when the surety has paid the debt owed by the principal debtor to the creditor, and that section 154(2) of the Companies Act does not alter this common law position.

Conclusion

The judgment makes it clear that a surety's right of recourse arises against the principal debtor when the surety has paid the debt owed by the principal debtor to the creditor, and that section 154(2) of the Companies Act does not alter this common law position.

The judgment is, however, not clear on what effect business rescue has on a surety's contingent claim against a principal debtor in business rescue and in particular in circumstances where the surety has not as yet paid the creditor of the principal debtor and accordingly the debt is not as yet due and owing by the principal debtor to the surety (but may however become owing at a later stage once the surety pays the principal debtor's debt).

Should a surety have a contingent claim against a company in rescue, it is important that the surety seeks legal advice in the business rescue proceedings of the principal debtor, since the effect of the business rescue may be that the surety's pre-commencement contingent claim is compromised in terms of the adopted business rescue plan and accordingly unenforceable once the debt becomes due and owing (which is when the surety pays the creditor). A surety wishing to later enforce a pre-commencement contingent claim, therefore needs to ensure that the contingent claim is not compromised in the business rescue plan and it is crucial that the surety informs the business rescue practitioner of the surety's claim so that it can be included in the plan. Even if the business rescue plan does not compromise the surety's claim, but the business is subsequently sold to a third-party purchaser, the surety may sit with a judgment against an empty shell without any assets.

Considering the complicated nature of a surety's right to recourse during business rescue, it is important that, if you have signed a suretyship agreement and the principal debtor goes into business rescue, or if you are a creditor of a company in business rescue and you hold suretyships as security for the debts of the principal debtor, you consult with us for purposes of understanding your rights in the business rescue and the effect which section 154(2) of the Companies Act may have on these rights.

Tobie Jordaan, Kylene Weyers and Stephan Venter

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Cliffe Dekker Hofmeyr's Dispute Resolution rankings in THE LEGAL 500 EMEA 2020:

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CDH's Construction practice is ranked in Tier 2 in THE LEGAL 500 EMEA 2020.
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BBBEE STATUS: LEVEL TWO 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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