

The SAA Business Rescue Process : A steep learning curve – Lessons for SOEs

30 April 2021 11 min read

Setting the scene

Since being placed under voluntary business rescue in December 2019, South African Airways ("**SAA**") has been a consistent (and often controversial) conversation point amongst many South Africans. Being the first business rescue process involving a state owned entity ("**SOE**"), many observers regard the SAA business rescue as a "pilot test" that will ultimately determine whether business rescue proceedings, provided for in Chapter 6 of the Companies Act 71 of 2008 ("**Companies Act**"), are capable of breathing life into ailing SOEs.

Public interest in the outcome of the SAA business rescue is also heightened by the fact that despite being in rescue for close to a year and a half, SAA continues to cost South African taxpayers billions of Rands. What is certain, is that the SAA business rescue process has placed the concept of business rescue on the South African restructuring map – good, bad or indifferent!

Notwithstanding the onset of the Covid-19 pandemic and the resultant prohibitions on air travel for most of 2020 and to an extent in 2021, (that no doubt made the task of rescuing the national airline much more difficult), it has been reported that SAA is set to take to the skies in August of this year, and that its business rescue process is set to wrap-up in the near term. However, even with vital funding provided by government (in the sum of R10.5 billion), the future of the troubled SOE remains uncertain.

This uncertainty is compounded by the fact that Mango Airlines, one of SAA's subsidiaries that was once the glimmer of hope of the SAA group of companies, is also battling to stay afloat, with reports indicating that it is likely that the low-cost airline (that is set to temporarily suspend its operations from 1 May 2021) will also be placed under business rescue proceedings, and is currently unable to pay its employees' salaries. Mango Airlines' desperate financial situation is reportedly exacerbated by delays in the flow of funding from government, due to Parliamentary processes. Unfortunately, the woes of SOEs do not end here.

The arms manufacturer Denel is also facing financial distress, with reports indicating that Denel's various divisions will be unable to pay their employees' salaries from as soon as this month. Similarly, South African Airways Technical (a subsidiary of SAA) is also struggling to keep up with salary payments.

In view of the dire state of South African SOEs, it comes as no surprise that there is a heightened interest, by all stakeholders, in not only the outcome of the SAA business rescue process, but also in whether business rescue proceedings as a process, is a workable solution for SOE's in general.

The objectives of business rescue proceedings are to either return a financially distressed company to solvency, or if that is not possible, to provide a better return to creditors or shareholders than that which would be achieved in an immediate liquidation of the company. With this in mind, the critical question posed by many, is whether business rescue proceedings are a viable option for financially distressed SOEs.

At the outset, it is obvious that this question is a difficult one, as the success or otherwise of each business rescue process will depend on the facts, circumstances and challenges unique to the financially distressed SOE, as well as the prevailing economic conditions.

However, having said this, there are some key takeaways that one can distil from the SAA business rescue process (and the case law arising therefrom) that not only illustrates the unique challenges faced by SOEs, but that may also assist SOEs navigating the business rescue process in the future. These takeaways will be the basis of the discussion that follows.

Relationship with labour

Whilst the SAA business rescue process is still ongoing, it has already left its mark on the law relating to business rescue. This is especially so in relation to employment related matters. The first notable contribution to the law on business rescue is that of the Labour Court in *NUMSA v South African Airways (SOC) Limited (in business rescue) and others*,^[1] which was confirmed on appeal in *South African Airways (SOC) Ltd (in Business Rescue) and others v NUMSA obo Members and others*.^[2] These judgments firmly establish that a business rescue plan is a necessary precondition for the commencement of any retrenchment processes under the Labour Relations Act 66 of 1995, during business rescue proceedings. The courts further confirmed that, in the absence of a business rescue plan contemplating retrenchments, the issuing of retrenchment notices is premature and procedurally unfair.

The upshot of this is that, where dismissals based on operational requirements are necessary, in view of the financial position of the distressed entity, business rescue practitioners will be required to prepare and present business rescue plans swiftly and without delay.

This may pose challenges, especially in the case of SOEs with complex businesses and operations, and which require substantial capital or post-commencement finance (including from government) to restructure their affairs. In such instances, it is unlikely that a business rescue plan will be published within 25 days of the appointment of the business rescue practitioner, as contemplated in section 151(5) of the Companies Act.

Another key judgment of the Labour Court is that of *NUMSA obo Members and another v South African Airways (SOC) Ltd and others*,^[3] where it was confirmed that only the High Court is empowered to uplift the general moratorium on legal proceedings provided for in section 133 of the Companies Act. As such, employees that wish to commence legal proceedings in the Labour Court against their employer that has been placed in business rescue must do so in accordance with the provisions of section 133, by either obtaining written consent from the business rescue practitioners or leave from the High Court.

This conclusion, especially in relation to SOEs, is critical as business rescue proceedings affect the rights of several stakeholders that go beyond the employment relationship, and the High Court is usually best placed to balance the relevant rights and interests in an application for leave to commence legal proceedings or enforcement action against a company in business rescue.

The principles discussed above are important aspects to consider in any business rescue process. However, the key takeaway from the SAA business rescue process, is that maintaining a constructive relationship with employees and organised labour is critical to the success of the business rescue process, especially where the company's aim is to trade its way out of its financially distressed situation. Standoffs with trade unions and employees, as we have seen in the case of SAA, are a significant impediment to the rescue process, which result in delays and unnecessary costs.

As such, a delicate balance must be struck in the restructuring process, based on the recognition that whilst employees are undoubtedly the lifeblood of the company, it is often necessary for distressed companies to reduce their operating expenses, through retrenchments. Of course, striking this balance is difficult, more so in the case of SOEs, where government has as one of its objectives the creation and maintenance of employment.

This necessarily gives rise to tensions, as SOEs are subject to certain expectations that are not always present in the case of non-state owned companies.

With this being said, it must be kept in mind that the business rescue process is aimed at value preservation. An impasse on labour issues may very well result in the collapse of not only the restructuring process, but also the company itself, which will likely be placed into liquidation. This is undesirable, especially in the case of key SOEs such as SAA, as the knock-on effects will result in job losses in not only the SOE itself but also in the related businesses that form part of the value chain.

Post-commencement finance

An equally important aspect of the rescue process relates to acquiring post-commencement finance. Post-commencement finance, much like a constructive relationship with trade unions, is critical to the effective rescue of any financially distressed company. Oftentimes, a company placed under supervision will immediately require some form of ongoing finance in order to continue trading and where it can continue to make payment of its ongoing overhead costs.

Without such financing, the business rescue process will in all likelihood fail, and the company will end up in liquidation. Therefore, a key component in every business rescue plan is securing turnaround finance to, *inter alia*, meet the company's working capital requirements and restructuring costs.

Given the circumstances surrounding post-commencement finance, section 135 of the Companies Act provides a level of statutory protection to post-commencement financiers, such that they rank as super-priority creditors and enjoy a preference over the company's pre-rescue creditors. Post-commencement finance can be obtained from various sources, including the company's existing lenders (the banks), the company's shareholders, private equity providers and from third party acquirers of the company.

In the case of SAA, a large part of its funding has to date been provided by government, as sole shareholder, either in the form of direct financing or through government debt guarantees. However, as we have seen in the case of the SAA business rescue, obtaining government funding is not without its challenges, especially in light of the ever-increasing demands placed on the strained South African fiscus.

In view of this, SOEs may have to seriously consider alternatives to government funding. Privatisation through private equity investments and/or debt equity swaps with creditors, are alternatives that have been suggested over the years. However, it is without a doubt that political considerations play a major role in this determination, taking into consideration the case made for the public ownership of state assets.

The Public Finance Management Act

Another unique feature that arises in the context of business rescue proceedings involving SOEs is the Public Finance Management Act 1 of 1999 ("**PFMA**"). The PFMA is aimed at, *inter alia*, regulating financial management in government, and ensuring transparency, accountability, and sound management of the revenue, expenditure, assets and liabilities of the institutions to which it applies. Business rescue practitioners that take up appointments in business rescue proceedings involving SOEs will be required to comply with the provisions of both the Companies Act and the PFMA for the duration of the rescue process.

As we have seen, the provisions of the Companies Act and the PFMA are sometimes at cross-purposes, and which may lead to a wide range of complex issues. For instance, the PFMA provides for certain procedures that must be adhered to and authorisations that must be obtained by SOEs when, *inter alia*, alienating or encumbering state assets, or concluding agreements involving future financial commitments.

These provisions of the PFMA may, in certain circumstances, be incongruent with the extensive management powers afforded to business rescue practitioners under the Companies Act, which are aimed at the efficient running of the rescue process.

Conclusion

Business rescue proceedings involving SOEs present unique challenges that exist over and above those that are typically expected during the restructuring process. Business rescue practitioners and the various stakeholders must therefore be alive to the various issues and complexities, including those touched on above.

Having said this, this discussion is by no means an exhaustive attempt at dealing with all the issues that may possibly arise during the course of business rescue proceedings involving SOEs. Ultimately, the issues that arise during the business rescue process will largely be determined by the facts, circumstances and challenges unique to the particular SOE. However, the aim of this discussion was to highlight the key takeaways or lessons that may be learnt from the SAA business rescue process.

These takeaways may provide useful guidance for financially distressed SOEs that may enter into business rescue proceedings in the future. Business rescue proceedings remains an attractive option for financially distressed entities that seek a fresh start as solvent entities, whilst preserving jobs and their place in the market.

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[1] *National Union of Metalworkers of South Africa obo Members v South African Airways (SOC) Limited (In business rescue) and others* 2020 (7) BCLR 888 (LC).

[2] *South African Airways (SOC) Ltd (in Business Rescue) and others v National Union of Metalworkers of South Africa obo Members and others (3)* [2020] 8 BLLR 756 (LAC).

[3] *National Union of Metalworkers of South Africa (NUMSA) obo Members and another v South African Airways (SOC) Ltd and others* [2021] JOL 49821 (LC).



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