Do arbitration proceedings constitute legal proceedings?

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Section 133 of the Companies Act 71 of 2008 provides for a general moratorium on legal proceedings against a company in business rescue. The section states that, during business rescue proceedings, no legal proceeding against the company, or in relation to any property belonging to the company, or lawfully in its possession, may be commenced or proceeded with except with the written consent of the business rescue practitioner (BRP) or with the leave of the court.

The Companies Act, however, does not provide a definition of the term "legal proceeding". This article examines its meaning.

Relevant case law

The courts have attempted to give the term "legal proceeding" meaning.

In *Van Zyl v Euodia Trust (Edms) Bpk 1983 (3) SA 394 (T)* the court stated that the ordinary meaning of a "legal proceeding" is a "law suit" or a "hofsaak". In *Lister Garment Corporation (Pty) Ltd v Wallace NO 1992 (2) SA 722 (D)* the court accepted the definition as set out in the *Van Zyl* case. Both of these cases dealt with security for costs in "legal proceedings" by companies and body corporates in terms of section 13 of the Companies Act 61 of 1973 (the Old Companies Act). It is important to consider that these cases did not interpret the term "legal proceeding" within the context of insolvency law.

The test as set out in *Van Zyl* was recently accepted in the case of *Chetty t/a Nationwide Electrical v Hart NO and Another (12559/2012) [2014] ZAKZDHC 9* (25 March 2014).

The *Chetty* case

In this case, an arbitrator made an arbitration award at a time when the defendant in arbitration proceedings was under business rescue in terms of section 129 of the Act. The applicant argued that as the BRP did not consent in writing, nor did the court grant leave for the proceedings to continue as envisaged by section 33, the award was defective and should be set aside.

The setting aside of the award was sought on the grounds that:

- It had been improperly obtained as it was issued when the defendant in the arbitration had failed to disclose that it was under business rescue.
- The continuation of the proceedings, which were part heard, was not permissible in terms of

section 133 of the Act.

- The arbitrator committed a gross irregularity by allowing the proceedings to continue.
- The arbitrator also exceeded his powers in publishing an award during business rescue because he lacked the legal capacity to do so.

The arbitrator refused to follow *Bristol Airport plc v Powdrill and Others [1990] 2 ALL ER 493 (CA),* which dealt with whether the leave of the court or the consent of an administrator of an insolvent airline company was required before an airport could exercise its right to detain aircraft for unpaid airport charges. The court in the *Bristol Airport* case decided that the words "no other proceedings may be commenced or continued" meant either legal proceedings or quasi-legal proceedings such as arbitration. The court in *Bristol Airport* also stated that "judicial or other proceedings" would include proceedings other than judicial (legal) proceedings. The arbitrator in the *Chetty* case, however, rejected this interpretation on the basis that section 133 specifically refers to legal proceedings and not only to proceedings. The arbitrator then referred to the *Van Zyl* case and accepted that a "legal proceeding" is a "law suit" and, on that basis, held that arbitration proceedings do not constitute legal proceedings for purposes of section 133.

It appears that the judgment in the *Chetty* case is incorrect as the arbitrator applied case law that was not decided in the context of insolvency law and therefore not applicable to section 133 of the Companies Act. As the *Chetty* case dealt with a company in business rescue and therefore insolvency law, the arbitrator erred in not applying the *Bristol Airport* case, which specifically dealt with the interpretation of "legal proceedings"' in the context of insolvency.

Interpretation of the meaning "legal proceeding" within the context of the Companies Act, the old Companies Act, and the Arbitration Act

It is important to examine the meaning of the term "legal proceeding" within the context of the Companies Act, the Old Companies Act, and the Arbitration Act 42 of 1965.

The Companies Act

Section 5(1) of the Companies Act states that it must be interpreted and applied in a manner that gives effect to the purposes set out in section 7. One of the purposes of the Act as contained in section 7(k) is for the efficient rescue and recovery of financially distressed companies, in a manner that balances the rights and interests of all relevant stakeholders. Section 158(1)(b) states that the courts must promote the spirit, purpose and objects of the Companies Act and if any provision, read in its context, can be reasonably construed to have more than one meaning, the meaning that best promotes the spirit and purpose of the Act and will best improve the realisation and enjoyment of rights, must be preferred.

At a purposive level, the exclusion of arbitration proceedings from the moratorium will lead to the business rescue process not being an efficient procedure as envisaged by section 7(k). This is mainly because a company in business rescue could be subject to the costs, and demands on management time, of arbitration proceedings without the consent of the BRP or without leave of the court. This burden could force a company in business rescue into liquidation, defeating the

whole purpose and objective of section 133. The moratorium granted by section 133 is designed to provide the company with a breathing space to enable it to find a solution to the financial problems it is experiencing, and for the BRP to design and implement a business rescue plan to achieve this.

Arbitration proceedings are usually more expensive than normal court proceedings and it therefore does not make sense, therefore, to protect a company from normal court proceedings but not to protect it from the costs and time demands of arbitration proceedings, which may also take years to resolve. An arbitration award made against a company in business rescue could certainly doom the company to failure. It goes against the spirit of Chapter 6 of the Companies Act to subject a company to arbitration proceedings without the written consent of the BRP or leave of the court.

Henochsberg is also of the opinion that it is clear that the intention of section 133 of the Companies Act is to cast the net as wide as possible in order to include any conceivable type of action against the company, including matters before other bodies like the Consumer Commission and the Competition Commission.

It should be borne in mind that the suspension of legal proceedings, including arbitration proceedings against a company in winding-up, does not prejudice the claimant, because the law of insolvency provides a mechanism for creditors to prove their claims other than by litigation – namely, by lodging a proof of claim affidavit. Similar considerations apply in business rescue.

The Arbitration Act

Of crucial importance is section 5(2) of the Arbitration Act, which states that in the case of a corporate body being a party to such an arbitration, if there is a petition for the winding-up or for placing the corporate body under judicial management, or an order is made for the winding-up or for placing the corporate body under judicial management, the provisions of any law relating to the winding-up or judicial management of the corporate body concerned shall apply in the same manner as if a reference of a dispute to arbitration were an action or legal proceedings within the meaning of any such law.

Section 5(2) makes it clear that references to legal proceedings in the winding-up provisions of the Old Companies Act must be construed as including arbitration proceedings.

Old Companies Act

Section 359(1) provides that when a company is wound up, all civil proceedings against the company are automatically suspended until the appointment of a liquidator. Section 359(2) states that within four weeks of the appointment of a liquidator, anyone who intends to continue legal proceedings against a company suspended by a winding-up, and everyone who intends to institute legal proceedings to enforce any claim against the company that arose before the commencement of the winding-up, must give not less than three weeks' notice in writing before continuing or commencing the proceedings.

In the light of section 5(2) of the Arbitration Act it is clear that arbitration proceedings against a company in liquidation are suspended by the winding-up. The counterparty cannot proceed with the arbitration until a final liquidator has been appointed and advance notice that the arbitration proceedings will continue has been given to the liquidator.

It seems illogical that legal proceedings would include arbitration proceedings for the purposes of liquidation but not for the purposes of business rescue. The court in *Chetty,* however, appears to have overlooked these considerations entirely.

Conclusion

There can be no dispute that arbitration proceedings constitute legal proceedings for purposes of insolvency law. Not only is the law clear on this, but when reading section 133 within the context of the purposes of the Companies Act and taking into account that the spirit of Chapter 6 is to rescue ailing companies, it becomes clear that the moratorium also applies to arbitration proceedings. I respectfully submit that the interpretation of "legal proceedings" in the Chetty judgment is incorrect. The arbitrator applied case law that had nothing to do with insolvency law.

Although arbitration is a private judicial hearing, it is still a judicial hearing and its outcome binds the parties. A party's claim shouldn't be differentiated between according to whether it was instituted by way of summons or by way of arbitration – both routes fulfil the same purpose and have the same effect on a party's rights and obligations. An arbitration impacts financially on a company's prospects of success in business rescue and the written consent of the BRP or leave of the court should be required before arbitration proceedings against the company may be commenced. Business rescue proceedings are instituted to allow a company's affairs to be restructured in such a way as to allow it to continue operating as a profitable concern. Controls need to be put in place to achieve this and the moratorium protects a company in business rescue by ensuring that a third party goes through the BRP or court to enforce its rights. The efficiency of Chapter 6 would be highly compromised if a third party could subject the company in business rescue to arbitration proceedings without restriction.

I therefore submit that arbitration proceedings constitute legal proceedings as contemplated by section 133 of the Companies Act for which the consent of the BRP or leave of the court is required. It is hoped that further case law will clarify this issue in the near future.

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