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CORPORATE & COMMERCIAL ALERT

IN THIS **ISSUE**

COVID-19 Corporate & Commercial Legal Considerations Webinar | 9 April 2020: More answers to your questions

Since early 2020, the world has been confronted with the deadly COVID-19 pandemic. Particularly since early March 2020, many countries have requested or enforced social distancing, curfews and/or lockdowns to mitigate and suppress the spread of the virus, often with adverse effects on many sectors of each economy. South Africa has been no exception.

BLACK ECONOMIC EMPOWERMENT Can black people front?

The commission of a fronting practice is criminalised under the Broad-Based Black Economic Empowerment Act (B-BBEE Act). A fronting practice is any transaction, arrangement or conduct that undermines or frustrates the achievement of the objectives of the B-BBEE Act or its implementation.

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Self-evidently, many parties will struggle to meet their contractual obligations. Understanding the impact of the pandemic generally, and more specifically the lockdown instituted in South Africa, on persons' business and contractual relationships is thus of paramount importance.

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Self-evidently, many parties will struggle to meet their contractual obligations. Understanding the impact of the pandemic generally, and more specifically the lockdown instituted in South Africa, on persons' business and contractual relationships is thus of paramount importance.

Pursuant to our Corporate and Commercial practice area's webinar on the impact of COVID-19 in the business and company law context, a number of questions arose which fall into common themes. As indicated during the webinar, we have addressed some of these issues on a general and high-level basis in this alert.

What is a party's recourse if the agreement does not contain a *force majeure* or similar clause?

Subject always to what the agreement may say to the contrary, general principles of contract law would apply. One of those is that a party's obligations under an agreement are excused to the extent that it is objectively impossible to perform those obligations due to external changed circumstances. This would include due to *vis major*, as in the current circumstances given the sudden and uncontrollable change in external circumstances brought about by COVID-19 and the resultant lockdown.

There is, however, no general doctrine or concept in South African contract law pertaining to changed circumstances (such as the principle *rebus sic stantibus* which is found in other jurisdictions). One would have to undertake an analysis of the parties' particular facts and agreement to determine whether specific principles and doctrines such as (i) supervening impossibility, (ii) remission of rental (which is essentially a lease-related subset of supervening impossibility), (iii) the reading in of tacit terms into the contract, (iv) the discretion of a court to refuse specific performance, and/or (v) public policy or constitutional law principles, could bring about some degree of recourse.

Additionally, sometimes a specific statute (e.g. the Consumer Protection Act, Conventional Penalties Act or Companies Act) applies to or regulates the particular arrangement, and such statute may offer some remedies or relief in this regard. For example, in terms of Section 48(5) of the Companies Act, a court may grant relief to a company which has concluded an agreement to repurchase its own shares and which is now experiencing solvency and liquidity issues.

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Severability, on the other hand, pertains to the ability to sever valid and enforceable portions of an agreement from the rest which may have become unenforceable as a result of the lockdown.

How do *"reciprocity"* and *"severability"* fit into the picture?

Reciprocity is a principle in contract law which is essentially to the effect that a party may withhold its performance under an agreement if the counterparty fails to perform its obligations. The legal concept is that of *exceptio non ademplati contractus*. If, for instance, as a result of the pandemic or the lockdown one party's obligations become impossible to perform, and this constitutes supervening impossibility, the counterparty's obligations are also suspended or possibly even terminated. However, the obligations need to be reciprocal, which is always a question of fact and interpretation of the particular agreement: Is the one performance a *quid pro quo* for the other? There may not always be a straightforward answer to this question in the context of multiparty agreements with numerous performances owed by the various parties.

Severability, on the other hand, pertains to the ability to sever valid and enforceable portions of an agreement from the rest which may have become unenforceable as a result of the lockdown. Severability applies in common law, and more often than not the agreement itself will have a severability clause. The question however is always whether the unenforceable portion, sought to be severed from the rest, is nevertheless so integral and fundamental to the agreement as a whole that its severability is not realistic or practicable – in which case severability will not apply.

How does the CIPC's practice note on Section 22 of the Companies Act fit into the picture?

Section 22 of the Companies Act provides that a company is prohibited from carrying on its business recklessly, with gross negligence or with an intent to defraud creditors. There is case-law to the effect that directors of a company may in principle, by virtue of Section 218(2) of the Companies Act, incur personal liability for loss or damages suffered by third parties, such as creditors, as a result of allowing the company to trade in such circumstances (*Rabinowitz v Van Graan and Others* 2013 (5) SA 315 (GSJ)).

This remains the case throughout the lockdown and the COVID-19 pandemic. Section 22 also goes on to provide that the Companies and Intellectual Property Commission (CIPC) may direct a company to desist from trading recklessly or in commercially insolvent circumstances. CIPC has issued practice note 1/2020 stating that it will not act in terms of this particular part of Section 22 in circumstances where the company is only temporarily insolvent as a result of the sudden change in economic circumstances – this is of course a reasonable and welcome measure.

But the CIPC's note is by no means a blanket *"exemption"* which somehow results in a wholesale disapplication of Section 22 during the pandemic: companies and their directors must continue to abide by Section 22 and may

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In order for a tenant to succeed in a claim for remission of rent, it must show that the diminished use and enjoyment of the premises let are as a direct result of *vis major*, which made it impossible for the lessor to fulfil its obligation.

therefore not trade recklessly. The typical example of such conduct, as expounded in the case-law, is continuing to incur debt without any reasonable belief that the creditor will be repaid.

Would the common law of supervening impossibility serve as a defence for non-essential retail tenants to avoid payment of rental during the lockdown period?

Yes, but in most instances only for the lockdown period and only to the extent that the use and enjoyment of the property in question has been diminished. This is always subject to what the lease agreement may provide, save perhaps for CPA leases referred to below.

Where the lessor's obligation to provide the use and enjoyment of the property let becomes wholly or partially impossible to perform, the lessee's reciprocal obligation to pay rent is also extinguished or reduced in proportion to the extent to which such use and enjoyment of the property is diminished, unless the lessee contractually assumed the risk of the lessor's performance becoming impossible.

In order for a tenant to succeed in a claim for remission of rent, it must show that the diminished use and enjoyment of the premises let are as a direct result of *vis major*, which made it impossible for the lessor to fulfil its obligation.

Legislation can constitute *vis major* in that it is out of the parties' control and cannot be resisted (*Bayley v Harwood* 1954 (3) SA 498 (A)). The lockdown, as distinct from the COVID-19 pandemic itself, accordingly (also) constitutes *vis major*, since this constitutes the regulatory confinement of persons to their places of residence and the mandated closure of all businesses and operations, other than, broadly, the provision of essential goods and services.

Can a rental remission be claimed after the full rental has been paid?

Yes. Paying rent in full will not extinguish a claim for remission where the lessee is legally entitled to same *(Ethekwini Metropolitan Unicity Municipality (North Operational Entity) v Pilco Investments CC* (320/2006) [2007] ZASCA 62)). This will in fact be required where the lease provides that rental must be paid in advance and/or where the extent of remission the lessee is entitled to is not readily ascertainable.

What if your lease specifically says you are not entitled to a remission of rental in any circumstances? Can you still rely on common law?

The common law position set out above will generally not prevail if the parties in terms of the agreement have accounted for a *vis major* occurrence by the inclusion of specific clauses which vary the common law position.

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There are a number of provisions in the CPA that regulate what can and cannot be contained in agreements with consumers and then also provisions that are imported by legislative reference such as common law principles of warranties of fit for purpose and merchantability.

These clauses may not prevail in the case of so-called *"CPA leases"*, discussed in more detail below.

We further note that the enforcement of such provisions which exclude rent remission may possibly be challenged on the basis of public policy and/or because it is constitutionally offensive to enforce same. This is an area of contract law which is still in a degree of flux. The onus in such scenario would be on the lessee to demonstrate that in the circumstances it would be contrary to public policy for the clause in question to be enforced.

Could you confirm how a CPA lease is defined, and what the implications are?

A *"CPA lease"* is a lease which is subject to the provisions of the Consumer Protection Act 68 of 2008 (CPA).

The CPA applies to a customer (i.e. a tenant) which is a natural person or a juristic person with an asset value of or annual turnover of less than R2,000,000 (CPA Tenant).

There are a number of provisions in the CPA that regulate what can and cannot be contained in agreements with consumers and then also provisions that are imported by legislative reference, such as common law principles of warranties of fit for purpose and merchantability. Also, being consumer legislation, the CPA specifically outlaws unfair contract terms and generally favours the more vulnerable or those with less bargaining power.

Certain sections like Section 54 prescribe a remedy for non-performance of *"services in a manner and quality that persons are generally entitled to expect"* being to *"refund to the consumer a reasonable portion of the price paid for the services performed and goods supplied, having regard to the extent of the failure."*

Section 54 can be interpreted as conferring a statutory remedy similar to the common law with respect to remission of rent. Under this interpretation, a CPA Tenant could have a statutory remedy available outside of their common law remedy for a reduction of rental payable to the extent that the tenant's use and enjoyment of the property let has been diminished.

Regarding the remission period can the landlord extend the lease terms or increase the rental to offset the remission period?

Absent a specific provision to this effect in the lease agreement, a lessor is not entitled to unilaterally vary the provisions of the lease merely because the lessee has or had a claim for remission of rent. As the lessor is unable to perform its obligation of delivering use and enjoyment of the premises let to the lessee for the period in question (likely the lockdown period), the lessee's reciprocal obligation to pay rent is proportionately extinguished for that duration, and the agreed contractual position continues to bind the parties and cannot be unilaterally altered once the temporary supervening impossibility of performance has come to an end.

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The legal position remains unclear as to what exactly constitutes rent for purpose of the application of the remission principle.

Is there case law on the remission of operational costs under a lease?

There are a number of obiter remarks such as in *Genac Properties Johannesburg (Pty) Ltd v NBC Administrators CC* (Previously NBC Administrators (Pty) Ltd) 1992 (1) SA 566 (A) where the Appellate Division expressed the view that certain *"maintenance and running expenses"* provided for separately to rent in the lease in question, including assessment rates, levies, security costs, cleaning costs, certain insurance premiums, the costs of maintaining and/or servicing the lifts and/or air conditioning in the building, and electricity and/or water consumption costs, constituted *"rent"* as they formed part of the *quid pro quo* paid by the lessee for the use and enjoyment of the premises let.

In our view, however, there are strong arguments to be made that certain, if not all, of the operating costs contemplated in the impugned lease agreement in *Genac* do not constitute *"rent"*, as they are in respect of amenities, facilities and/or services that are in addition and ancillary to the use and enjoyment of the premises let, and thus do not form part of the *quid pro quo* for the use and enjoyment of such premises.

The legal position remains unclear as to what exactly constitutes rent for purpose of the application of the remission principle. Here the facts and circumstances, and particularly the terms of the lease agreement, in question would be very important.

Yaniv Kleitman, Allan Hannie, Peter Hesseling, Albert Aukema and Joshua Reuter

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This alert is being published purely for information purposes and is not intended to provide our readers with legal advice. Our specialist legal guidance should always be sought in relation to any situation. It is important to note that this is a developing issue and that our team of specialists will endeavour to provide updated information as and when it becomes effective.

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BEE: Can black people front?

Fronting, as well as other offences such as misrepresenting or attempting to misrepresent the B-BBEE status of an entity or providing false information to a verification professional or to any organ of state or public entity, carries a penalty of a fine and/or imprisonment of up to 10 years.

The commission of a fronting practice is criminalised under the Broad-Based Black Economic Empowerment Act (B-BBEE Act). A fronting practice is any transaction, arrangement or conduct that undermines or frustrates the achievement of the objectives of the B-BBEE Act or its implementation.

Fronting, as well as other offences such as misrepresenting or attempting to misrepresent the B-BBEE status of an entity or providing false information to a verification professional or to any organ of state or public entity, carries a penalty of a fine and/or imprisonment of up to 10 years. In the case of an entity other than a natural person the fine can be as much as 10% of its annual turnover.

The mischief the legislature is seeking to address, amongst other things, is to ensure that those entities and persons seeking to achieve B-BBEE compliance do so in manner that does not amount to a sham, as this will most certainly undermine or frustrate the achievement of the objectives of the B-BBEE Act. It will be a sham if, for example, a black person is appointed to a senior managerial position notionally responsible for managing a division or business operation but then that black person is effectively precluded or discouraged from actually discharging that function or exercising the rights and responsibilities flowing from that position.

Another example of a sham that could amount to fronting is if a black person acquires shares in an entity with the expectation that she would be entitled to an economic return based on her ownership of that shareholding, only for it to later materialise that this is not the case as, unbeknownst to her, there is another arrangement in place whereby the economic benefits that would have been due to her in the ordinary course, are effectively diverted to, say, the other shareholders.

In both these examples, the black persons involved were effectively misled and certainly were not party to the sham. But what if, for whatever reason, the black person involved was knowingly a party to the sham arrangement?

This could happen in a scenario where, for instance, the black person appointed to a senior managerial position knows that she does not have the requisite skills or competencies to execute the function assigned to her (and is reasonably unlikely to be able to acquire those skills and competencies) – and ultimately, that she will hold that managerial position in name only – but nevertheless (for whatever reason) goes along with it.

Another example is where a black person acquires a certain shareholding in a company knowing that she is not going to receive the economic benefits that

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In these circumstances we would suggest that it matters not whether you are black nor whether you may also have been prejudiced through the execution of the unlawful scheme.

would normally be associated with that shareholding, but nevertheless goes along with the arrangement, and in so doing is party to misrepresenting the actual B-BBEE status of the company.

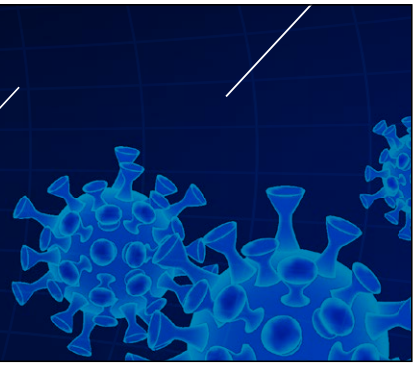
In these instances, the black person involved is arguably no longer a victim but actually party to the unlawful conduct.

An important consideration in this context is that the offence of fronting (and the other related offences) is committed when one 'knowingly' does so. 'Knowingly' is defined in the B-BBEE Act as meaning that a person either had actual knowledge or was in a position in which she, acting reasonably, ought to have had actual knowledge or otherwise investigated the matter or taken other measures which, if taken, would reasonably be expected to have provided such actual knowledge.

While there has always been a principle in our law that ignorance of the law is no excuse, under the B-BBEE Act, ignorance of the facts, let alone the law, will not necessarily constitute a defence to a charge of fronting (or the related offences) as the Act requires one to actually take reasonable steps to ascertain the actual state of affairs. Merely indicating that "*I did not know what was actually going on*" if I was in a position where I could reasonably have ascertained this, will not help me if I am accused of fronting or one of the other related offences.

So, unless you have reasonably interrogated all relevant facts and circumstances, having regard to you role or position in relation to the B-BBEE transaction, scheme or initiative, you could also find yourself having to face criminal charges alongside the other perpetrators who devised and carried out the unlawful scheme. In these circumstances we would suggest that it matters not whether you are black nor whether you may also have been prejudiced through the execution of the unlawful scheme. If you wilfully or even negligently participate in an unlawful scheme or arrangement such as fronting you could also be the subject of criminal sanctions.

Allan Hannie and Kwadwo Owusu



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Cliffe Dekker Hofmeyr is very pleased to have achieved a Level 1 BBBEE verification under the new BBBEE Codes of Good Practice. 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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