DISPUTE RESOLUTION

BUSINESS RESCUE, RESTRUCTURING & INSOLVENCY

NEWSLETTER

Volume 7 | 12 May 2020

CDH
CLIFFE DEKKER HOFMEYR

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Business Rescue, Restructuring & Insolvency

There is plenty positivity surrounding the number seven. Seven colours in the rainbow, Seven Wonders of the World, seven seas, seven continents and 777 on a slot machine. However, seven weeks of lockdown is no one's friend, and the number seven is no longer my lucky number.

Whilst low risk offenders are being released from prison, our economy is still being held captive. Does this mean that my only way out of lockdown is to steal a loaf of bread?

It has become clear that it is no longer the virus that is the real pandemic, but rather the current state of our economy, as well as the job losses occasioned with the postponed lockdown. Employment remains a hot topic. On Friday, 8 May, the Labour Court handed down a judgment in the never-ending SAA business rescue saga. The court agreed with the National Union of Metal Workers of South Africa and the SA Cabin Crew Association and declared that the notice given by the business rescue practitioners to initiate the retrenchment process was invalid, as employees cannot be retrenched unless the retrenchment is contemplated in the business rescue plan. I understand that the order will be taken on appeal. We joined forces with the employment team at CDH and produced an alert on the judgment. You can read the alert here.

A few weeks back, when everyone still had a sense of humour, "*marble runs*" (marbles chasing downhill on a sandy man-made track) became the new T20. This kept all the sports lovers occupied but it seems that there is light at the end of the tunnel as Super Rugby will soon be making a comeback in New Zealand and Australia. I am in desperate need to kick up my feet and open a cold one while enjoying some sporting action. I can't wait to start looking forward to weekends again.

In this week's edition, we look at compromises as an alternative to business rescue proceedings. I agree with my partner, Richard Marcus, that it seems that most people have forgotten it exists.

Watch out for next week's edition. We are working on a piece wherein we will discuss the impact of business rescue proceedings on pending lease agreements, especially where the business rescue proceedings may be converted to liquidation.

Until next week.

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Practically, what has COVID-19 meant for the business rescue process?

Under the stage 5 national lockdown (i) the courts were all but closed save for matters of dire urgency, and in some courts only if related to COVID-19; and (ii) in terms of Regulation 165(3) of the Companies Act Regulations, the Companies and Intellectual Property Commission (CIPC) closed to the public, with no processing of documents or acceptance of filings.

There are only two ways to initiate business rescue proceedings, both requiring the alternative functioning of one of either CIPC or the court. Therefore their "*shut-downs*" had a direct impact on the commencement of the business rescue process.

Section 129 permits the directors of a company to pass a resolution placing the company into business rescue. Section 129(2)(b) prescribes that the resolution be filed with CIPC before it is of any force or effect. CIPC (Practice Note 3 of 2019) deems the date of filing as "*the date [on which] the minimum requirements, completed CoR123.1, sworn statement and resolution are submitted to CIPC*". These documents may, and is recommended should, be submitted to CIPC by email to businessrescue@cipc.co.za or corporatelegalservices@cipc.co.za. This is the most efficient manner in which to file a business rescue document with CIPC.

Alternative to a company resolution, section 131 allows any affected person to apply to court for an order placing the company under business rescue.

At a time where business rescue may have been the lifeline needed for many companies suffering from the impact of COVID-19 lockdowns, we briefly analyse, from a practical perspective, the effect that the limited access to the courts and CIPC during full (stage 5) lockdown has had on placing companies into business rescue.

Courts

There is no doubt that if a company is in financial distress, especially as a result of COVID-19, that the courts would have, and did find business rescue applications urgent. The conversion of the South African Express Airways' rescue to provisional liquidation is an example of this.

From a practical perspective therefore, unless the facts somehow contradicted a case of urgency, the limitation of access to the courts during COVID-19 would not have hindered the initiation of business rescue through a court application.

Resolution

The filing of section 129 resolutions are a different story entirely. CIPC issued a notice on 24 March 2020, before the national lockdown period kicked-in on 26 March 2020, notifying the public that CIPC would, amongst other things, not be accepting any filings. What does this mean for business rescues initiated in terms of section 129 during stage 5 lockdown?

It has been a heavily debated issue for some time now as to when a document is deemed as "*filed*" with CIPC. Is it the date it is stamped by CIPC or the date when all the necessary documents are filed at CIPC? According to CIPC's Practice Note 3 of 2019 (as quoted above), it should be the latter. From a practical perspective the debate became academic as CIPC generally tried to stamp the documents on the date of their receipt. However, this was obviously not happening during this stage 5 lockdown. The issue has therefore again, come to the fore.

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Practically, what has COVID-19 meant for the business rescue process? *...continued*

Speaking to prominent business rescue practitioner, Hans Klopper of BDO, he confirmed that he has been involved in a rescue where the filing of the resolution to commence business rescue proceedings took place on 25 March 2020, the day after CIPC's 24 March 2020 notice came into effect but before stage 5 lockdown. They acted as business rescue practitioners and a month later, whilst still under stage 5 lockdown, the company successfully came out of rescue.

Klopper said that, despite the CIPC's lockdown notice, the business rescue practitioners treated the date of filing as they have always done, being the date on which they sent all the necessary documents to CIPC in the prescribed manner and form.

Given CIPC's lockdown notice confirming it would not be accepting filings during stage 5 lockdown, one can easily imagine how the above stance could lead to some legal challenges for parties wishing to obstruct the rescue process. This gets especially complicated if a business rescue initiated during stage 5 lockdown was already well underway before stage 5 lockdown was lifted - first meetings would have been held, plans published, voted on, and, in some cases as illustrated above, even substantively implemented allowing the companies to come out of rescue.

Thankfully, however CIPC seems to have taken a pragmatic approach to the situation, recognising that "*exceptional circumstances such as these required exceptional processing practices by the CIPC in order to assist the economy and the general public at large to effectively re-start...Business rescue processes and the endorsement of an appointed business rescue practitioner requires immediate assistance... ".*

In terms of Practice Note 23 of 2020, if filed in the prescribed manner and form (i) all voluntary rescue applications filed with CIPC during the stage 5 lockdown period, will be processed by CIPC to reflect the dates on which it was filed; and (ii) business rescue practitioner appointments filed during stage 5 lockdown will be endorsed by CIPC to reflect the filing date. This implies the date upon which the documents were sent to CIPC between 24 March and 30 April 2020.

Sceptics scrutinising this particular Notice however will see that there is some room for technical challenges. While seeming to take a pragmatic approach, the Notice clearly states that "*filing*" means the resolution must be filed in the prescribed manner and form and accepted by CIPC to have complied with the Companies Act provisions. On this definition, even if the acceptance is backdated, there is room to argue that rescues filed during the stage 5 lockdown should not have proceeded until CIPC had confirmed its acceptance of the prescribed documents. That brings with it a whole set of new problems, and one could go around in circles trying to argue for and against whether the position taken by CIPC is clear and technically correct.

However, what is clear from the Notice is that CIPC is trying to ensure it assists the rescue process despite the lockdown – "*We are committed to assist every single business affected by this pandemic in the best way possible, while still adhering to legislative requirements as well as normal CIPC best practice*". Whether or not the Notice is crystal clear does not seem to be the central issue at the moment, the focus is, as it should be, on assisting the rescue process and being as pragmatic as possible. This is illustrated further by the fact that CIPC is going to try assist the continuance of business rescue processes if possible, even in situations where filings fail to meet the prescribed manner and form required by CIPC. Only if filings cannot be salvaged will they be invalid and must be renewed. What qualifies as "*cannot be salvaged*", will be assessed on a case by case basis.

In summary, it therefore seems that all business rescues initiated by resolutions will be deemed to have been filed on the date upon which all required documentation was sent to CIPC. Even those rescues where the documentation is flawed have an opportunity of being saved. This approach is in line with the spirit of the Companies Act in relation to rescues, which is to "*provide for the efficient rescue and recovery of financially distressed companies, in a manner that balances the rights and interests of all relevant stakeholders*", and should be commended.

Lastly, it should also be noted that the Practice Note 23 of 2020 has granted entities starting the rescue process now with a five day extension with regard to the appointment of the business rescue practitioner. This is, presumably, to allow CIPC to deal with the backlog resulting from the lockdown. In terms of section 129(3), CIPC has the authority to grant such an extension, so this should not become a contentious issue.

Belinda Scriba
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Compromise – dead duck or forgotten hero?

Many years ago, compromises were a "*hot*" way of restructuring companies in financial difficulties. This was particularly because of the tax benefits this procedure offered. Alas, these benefits are long gone. But compromise is still around as a formal procedure and in fact has been updated under the new Companies Act. It languishes in a single section (s155) at the end of the chapter dealing with business rescue, so most people seem to have forgotten that it exists.

Compromise – dead duck or forgotten hero? *...continued*

In certain circumstances it may be the best way to proceed and should never be overlooked as a potential debt restructuring option. In fact, considering it is better described as a "*scheme of arrangement*" and it may well be possible to preserve tax advantages if correctly structured.

What advantages does compromise offer, if any?

The big advantage is that it is the most informal way to restructure a company's affairs, and therefore theoretically the cheapest and fastest.

In essence, compromise is a procedure which enables a company to negotiate with all its creditors and bind them to a debt restructuring arrangement agreed to by the required creditor majority. It is worth noting that the company does not have to offer a compromise to all classes of its creditors, nor does a company have to be insolvent to make such an offer. In fact, companies could make arrangements with creditors by agreement which may not even require the formality of a scheme to be sanctioned under the section.

Like business rescue, compromise does not require court involvement at the initiation and approval stage, but does require court recognition, by way of application, to bind all creditors after approval. So the court must sanction the scheme in its discretion. It would be unusual for a court to undermine the wishes of the creditor majority which has voted in favour of such a scheme. This being said, the court may reject a scheme approved by creditors on grounds of public policy or "*commercial morality*".

If it is so simple, why is it not used more often? There are a few reasons.

Firstly, the step is initiated by board resolution on notice to all creditors. It will usually involve an admission that the company is unable to pay its debts. This is an act of insolvency which could initiate hostile liquidation proceedings – so it is risky. There is no protection to the company once it initiates the process - unlike business rescue.

Secondly, approval of compromise schemes requires high voting thresholds of the class of creditors to whom the compromise is offered. Approval must be by 75% of aggregate claim value at voting date of each class of creditor.

Thirdly, creditors vote separately on the proposed scheme by "*class*", and this is a term which lacks absolute clarity. The most accepted definition is that a class of creditors means creditors whose rights are similar enough to consult for their common interest, but the boundaries between different classes of creditors may not always be clear. The distinction is not necessarily confined, for example, to concurrent or secured creditors as there may be divisions within these classes.

A proposed compromise scheme is required by the Companies Act to contain certain information – a kind of "*business rescue plan lite*". This ensures that creditors are given sufficient information to make an informed decision. Class meetings themselves should be conducted with a level of formality to ensure due process. Companies may wish to appoint an independent "*receiver*" to assist them in implementing the scheme, and to assure creditors that it will be done correctly and transparently.

Compromise therefore can work effectively when a company has close relationships with its significant creditors and can place some level of trust in their co-operation. An example of where this could be effective is where there are investors and/or creditors who may wish to put in more money to clear historic trade debt at a discount for the future benefit of the company.

When boards are facing future trading difficulties they should at least consider if the debt structure of their company is such where compromise may be the simplest and most effective way to restructure debt, and to secure the company's future.

Richard Marcus
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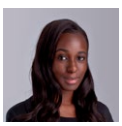

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