DISPUTE RESOLUTION

BUSINESS RESCUE, RESTRUCTURING & INSOLVENCY

NEWSLETTER

Volume 8 | 19 May 2020

CDH
CLIFFE DEKKER HOFMEYR

Tobie Jordaan
Director

Business Rescue, Restructuring & Insolvency

"I remembbbbeeeerrrr the days of my life....."

The other day my wife and I were reminiscing about our holidays before lockdown. The good old days with packed beaches, full restaurants and airport lounges. We were wondering if we would ever be able to make new memories again. That terrifying thought made me think of the iconic Volkswagen advertisement of the nineties. It is almost three decades later, and the lyrics are still so fitting ... *"magic moments, life is a mystery"*. If you were to replace *"life"* with *"lockdown"* or *"regulations"*, it could become our anthem.

We have thus far brought you eight weekly newsletters and we trust that we have kept you up to date on the possible impact which COVID-19 may have on your business and the economy. Copies of the previous newsletters can be downloaded here. We have decided to move over to monthly editions, with our next edition being published in the beginning of June. However, we are working on other initiatives, so please let us know if would prefer more regular updates.

In this week's edition, we consider the impact of a business rescue practitioner's right to suspend, for the duration of the business rescue proceedings, any obligation of the company that arises under an agreement to which the company was a party, at the commencement of the business rescue proceedings. Landlords are naturally concerned that their tenants may be placed under business rescue and that the obligation to pay rent will be suspended.

We conclude this edition with a discussion on a recent judgment where the court was rather strict and refused a business rescue application as it was not genuine and constituted an abuse of process. I suspect that in the next couple of months we will be notified of quite a number of companies filing for business rescue where the horse has already bolted and there is no real prospect of a successful rescue. Directors should take note of the court's findings in this regard.

I always knew that millennials would cope better during lockdown as they are already used to everything that technology offers. The millennial in my team recently proved this when she was admitted as an attorney of the High Court - via Zoom. She was just as excited as I was when I was admitted 12 years ago. She thought that this was the best experience ever and kept on telling me what a cool story this would be to tell her children one day. After all, we were always destined to move towards a world which is dominated and controlled by technology. COVID-19 just fast tracked our destiny. We must keep up with the younger generation and force ourselves to make new memories. As they say in the Volkswagen ad, *"this is my life and I am passing on the memories"*.

Tobie Jordaan
Director

PRIMARY CONTACTS

Tobie Jordaan
Director
T +27 (0)11 562 1356
M +27 82 417 2571
E tobie.jordaan@cdhlegal.com

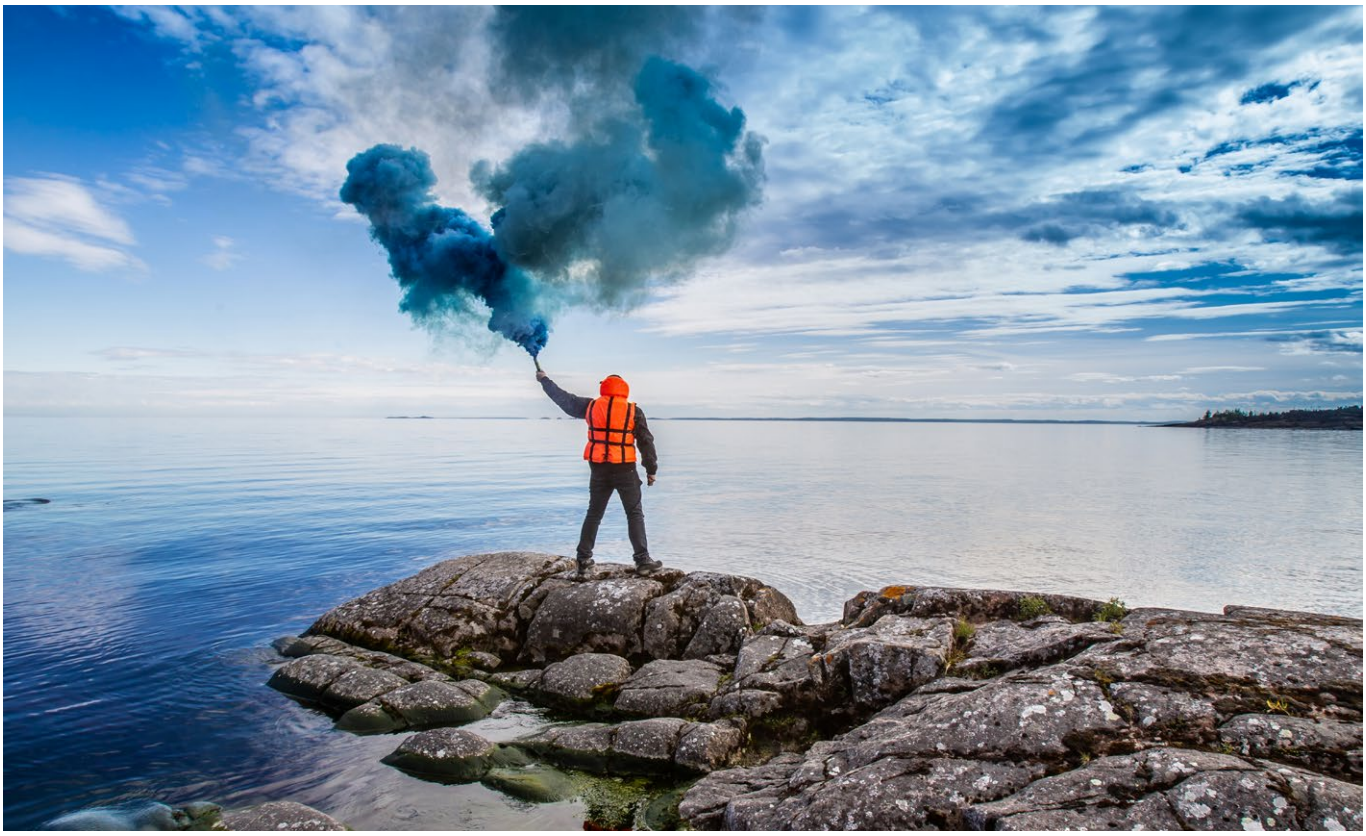
Richard Marcus
Director
T +27 (0)21 481 6396
M +27 82 902 9437
E richard.marcus@cdhlegal.com

Kgosi Nkaiseng
Director
T +27 (0)11 562 1864
M +27 76 410 2886
E kgosi.nkaiseng@cdhlegal.com

BUSINESS RESCUE, RESTRUCTURING & INSOLVENCY
NEWSLETTER
Volume 8 | 19 May 2020

My tenant is in business rescue and is not paying rent. What are my options?

The measures South Africa has put in place during the national lockdown has caused much economic strain on both individuals and businesses. The main reason for this, is that many businesses in South Africa have had to put all operations on halt, which has resulted in their income dropping dramatically. Since businesses across the country are experiencing cash flow constraints, we can expect a drastic rise in defaults on ever-growing lists of expenses – one of which being rental obligations.



But can a landlord cancel a lease agreement whilst the tenant remains under business rescue?

In terms of section 133(1) of the Companies Act 71 of 2008 (Companies Act), no legal proceedings, including enforcement action, may be commenced or continued with in any forum against the company, or in relation to any property belonging to the company, or lawfully in its possession, during the business rescue proceedings.

This section has caused for much debate in the South African legal fraternity, since some business rescue practitioners argued in the past, that if a party to a contract with a company under rescue, cancels an agreement, it would amount to "*enforcement action*". Since an "*enforcement action*" against a company is expressly prohibited whilst the company remains under business rescue, such cancellation would be unlawful. Parties trying to get out of contracts with companies under business rescue argued the contrary.

The debate was finally settled in the case of *Cloete Murray and Another NNO v FirstRand Bank Ltd t/a Wesbank* 2015 (3) SA 438 (SCA). The court held that that the cancellation of a contract does not constitute "*enforcement action*" prohibited by section 133(1) of the Companies Act, and that a creditor can therefore lawfully and unilaterally cancel a contract that it had concluded with a company under business rescue prior to the latter being placed under business rescue. One of the reasons provided by the SCA for the aforementioned conclusion, is that the terms "*enforcement*" and "*cancellation*"

My tenant is in business rescue and is not paying rent. What are my options? *...continued*

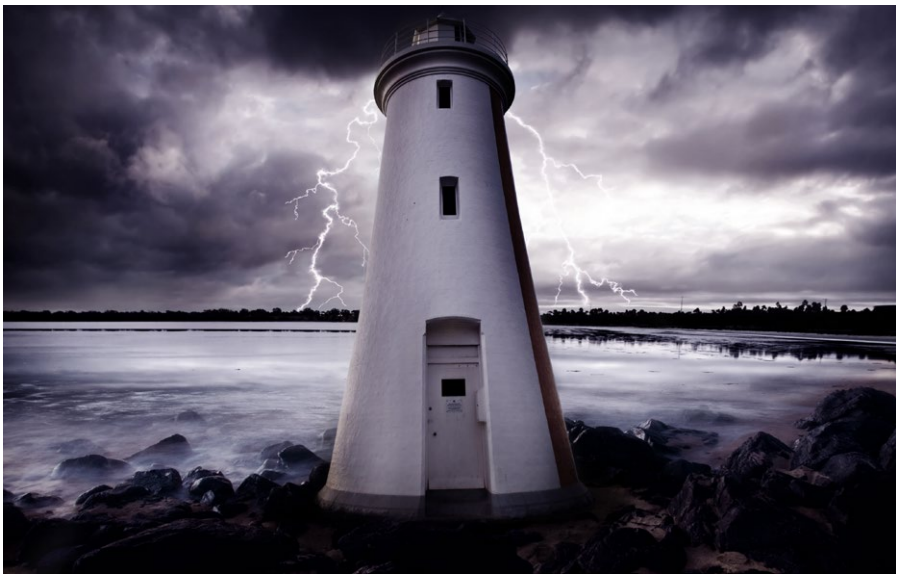
are mutually exclusive, and not interpreting them as such would be contrary to the language, context, provision and purpose of section 133(1) of the Companies Act.

However, section 136(2) of the Companies Act provides that during business rescue proceedings, the business rescue practitioner may entirely, partially or conditionally suspend, for the duration of the business rescue proceedings, any obligation of the company that arises under an agreement to which the company was a party at the commencement of the business rescue proceedings, which obligation would otherwise become due during the proceedings.

This could include the suspension of the company's obligation towards its landlord to pay rental. The question then remains as to whether this suspension of obligations could affect the landlord's right to cancel the lease agreement in the event that the tenant (under business rescue) fails to honour such obligations.

In the matter of *Kythera Court v Le Rendez-vous Café CC* 2016 (6) SA 63 (GJ), although the specific issue of the suspension of obligations by a business rescue practitioner in terms of section 136(2)(a) of the Companies Act was not the main dispute that the court had to preside on, Judge Boruchowitz mentioned obiter that:

> *"In the context of business rescue proceedings, the right to cancel a lease may be affected by the provisions of section 136(2)(a) of the Act. The section provides that the business practitioner may, despite any provision of an agreement to the contrary, entirely, partially or conditionally suspend, for the duration of the business rescue proceedings, any obligation of the company that arises under an agreement to which the company was a party at the commencement of the business rescue proceedings. By invoking this section, the business practitioner may prevent a landlord from cancelling a lease and from instituting eviction proceedings."*



There is, however, a potential counter argument which can be found in the common law principle of reciprocity. In the decision of *BP Southern Africa (Pty) Ltd v Intertrans Oil SA (Pty) Ltd and Others* 2017 (4) SA 592 (GJ), the court held that from the wide wording of section 136(2)(a), the suspension of an obligation by the business rescue practitioner, includes obligations that are contractually tied with a reciprocal obligation of the creditor. The court further stated that:

> *"Since the section is silent about the effect that the suspension has on such an obligation, and since the Legislature knew and knows the residual Law of Contract, it must be accepted that the creditor has available, subject to the normal rules, the exceptio non adimpleti contractus and, again, if the normal rules of materiality and contractual notices apply, the creditor also has available the normal rights of cancellation."*

Based on the court's *ratio decidendi* in the BP judgment, where a business rescue practitioner suspends an obligation to pay rent, the landlord would still have the right to, *inter alia*, cancel the lease agreement.

The suspension of obligations by business rescue practitioners, especially to pay rent, will certainly become a hot topic as companies are coming to terms with the damage that the lockdown has caused (and will continue to cause).

While it is clear that landlords will be able to cancel an agreement during business rescue (for a breach that occurred prior or post to the commencement of the business rescue proceedings), if the business rescue practitioner did not suspend the company under rescue's obligations in terms of section 136(2)(a) of the Companies Act, landlords will have to keep in mind that if the business rescue practitioner did suspend the company under rescue's obligation to pay rent, it could potentially complicate the cancellation of the lease agreement.

Tobie Jordaan
Director

Stephan Venter
Associate

Jessica Osmond
Candidate Associate

Vaughn Rajah
Candidate Attorney

BUSINESS RESCUE, RESTRUCTURING & INSOLVENCY
NEWSLETTER
Volume 8 | 19 May 2020

CDH
CLIFFE DEKKER HOFMEYR

Wolf in sheep's clothing – An analysis of whether applying for business rescue when liquidation proceedings have already commenced amounts to an abuse of process.

This judgment is the culmination of two separate applications before the Limpopo High Court (court), one being an application for the winding up of Madikor Sestien (Pty) Ltd (Madikor) by Vleissentraal Bloemfontein (Pty) Ltd and Vleissentraal Bosveld (Pty) Ltd (Vleissentraal creditors), and the other by Kremetart Trust, the sole shareholder of Madikor, for the commencement of business rescue proceedings of Madikor. The business rescue proceedings were opposed by the Vleissentraal creditors, as well as Vencor Holdings (Pty) Ltd (Vencor) as an intervening creditor.

At the centre of this judgment is Madikor's financial woes, which appears to have started as far back as 2013, although steps for its restructuring only commenced in 2015. Between 2015 and 2018, Madikor had signed various deeds of settlement and loan agreements in an attempt to avoid further court action and consequent liquidation. During 2016, Madikor entered, amongst other things, into a loan agreement with Vencor in terms of which a mortgage bond was registered over one of its immovable properties. Through this, Vencor became a secured creditor of Madikor. In December 2017, Madikor signed a settlement agreement with the Vleissentraal creditors whereby it undertook to have a mortgage bond registered over certain immovable properties belonging to Madikor which would lead to the Vleissentraal creditors becoming secured creditors of Madikor. In March 2018, Madikor signed a settlement agreement with another creditor, Kuyanda, in terms of which Madikor agreed to pay Kuyanda from the proceeds of the sale of certain of its [Madikor's] immovable property. Madikor was unable to fulfil some of the aforesaid undertakings.

It is thus not surprising that an application for the winding up of Madikor was brought by the Vleissentraal creditors, with Vencor as intervening creditor, and that a provisional winding up order was granted against Madikor in December 2018. A day before the return date for the provisional order was to be made final i.e. 19 March 2019, and on 18 March 2019, the Kremetart Trust launched an application to place Madikor in business rescue.

Wolf in sheep's clothing – An analysis of whether applying for business rescue when liquidation proceedings have already commenced amounts to an abuse of process...*continued*

It did not take long for both the Vleissentraal creditors and Vencor to oppose the business rescue application, citing various reasons for their opposition. The main point of opposition was that the application to place Madikor under business rescue constituted an abuse of process. Not only is the Kremetart Trust the sole shareholder of Madikor, but the deponent to the affidavit by Madikor opposing the winding up application and the deponent to the founding affidavit by the Kremetart Trust for a business rescue order to be granted, are one and the same person.

Yet in the founding affidavit, Madikor's true financial position was not disclosed to the court, the Kremetart Trust failed to prove, by providing the court with copies of title deeds, that the immovable assets it claimed were owned by Madikor, were in fact so owned or to provide the court with valuations in regard to the immovable assets, alleged to have been owned by Madikor.

Furthermore, the Kremetart Trust failed to disclose to the court the fact that all the proceeds of the sale of such immovable assets are due to the Vleissentraal creditors as secured creditors of Madikor and, therefore that such immovable property cannot be used to pay any of Madikor's other creditors under business rescue proceedings.

The court first dealt with the matter of the secured assets, whereafter it proceeded to consider the purpose of business rescue proceedings. The court confirmed that it is trite law that secured claims by creditors are protected in a business rescue, citing section 134(3) of the Companies Act 71 of 2008, along with two Supreme Court judgments.

The Kremetart Trust, as part of its application to place Madikor in business rescue, presented the court with a proposed business rescue plan which made provision for the gradual sale of certain immovable property owned by Madikor, which proceeds, so it was proposed, would then be used to pay its creditors, without any regard being had to the secured claims of the Vleissentraal creditors and Vencor. One would easily forgive the Vleissentraal creditors and Vencor for contending that this is essentially an informal liquidation, disguised as a business rescue.

In this regard the court held, with support from the *BP Southern Africa (Pty) Ltd v Intertrans Oil SA (Pty) Ltd* 2017 (4) SA 592 (GJ) case, that such security cannot be suspended by business rescue proceedings and the assets over which the security is held, can also not be disposed of without the consent of the Vleissentraal creditors and Vencor, as holders of the security over these assets. It confirmed that a company in business rescue wishing to dispose of secured property can only do so with the prior consent of the secured creditor, unless the proceeds of the sale will discharge the debt owed to the secured creditor in full. The court held that Madikor could not utilise the proceeds of the proposed property sales to pay other creditors in business rescue.

Turning its attention to the purpose of business rescue proceedings, the court reminded us that it "*will not sanction a business rescue which is in effect nothing but an informal liquidation process*". The purpose of a business rescue is, at its core, the rescuing of a company and the court held that the threshold test is whether there is a reasonable prospect of achieving a rescue and that "*the point of departure is that it is preferable to rescue a company than let it drift or plummet into extinction*". However, this does not mean that companies can use business rescue as a mechanism for avoiding its debts and the court echoed the warning in *ABSA Bank Limited v Newcity Group (Pty) Ltd* [2013] 2 All SA 146 (GSJ) that an attempt at business rescue must be genuine. The application brought by the Kremetart Trust was anything but genuine, so the court found.

The court found that the business rescue application amounted to an abuse of process on three grounds, namely the frustration of the final order of winding up, the lack of valuation of the properties to be sold and the failure to disclose further creditors Madikor was indebted to. As such, the business rescue application was refused, the court having spotted the wolf in sheep's clothing, attempting to slip into the pen.

After a delay of more than a year, the court was able to make a final judgment on the liquidation application. The court confirmed the proper approach to deciding whether a company should be wound up, namely whether a company can pay its debts as

Wolf in sheep's clothing – An analysis of whether applying for business rescue when liquidation proceedings have already commenced amounts to an abuse of process...*continued*

and when they become due in the ordinary course of business. It is of no consequence that a debtor's assets far outweigh its debts, if debts owed today cannot be paid today, the company is commercially insolvent. Therefore, the court is entitled to hold that the debtor is unable to pay its debts for the purposes of liquidation and grant an order for winding-up.

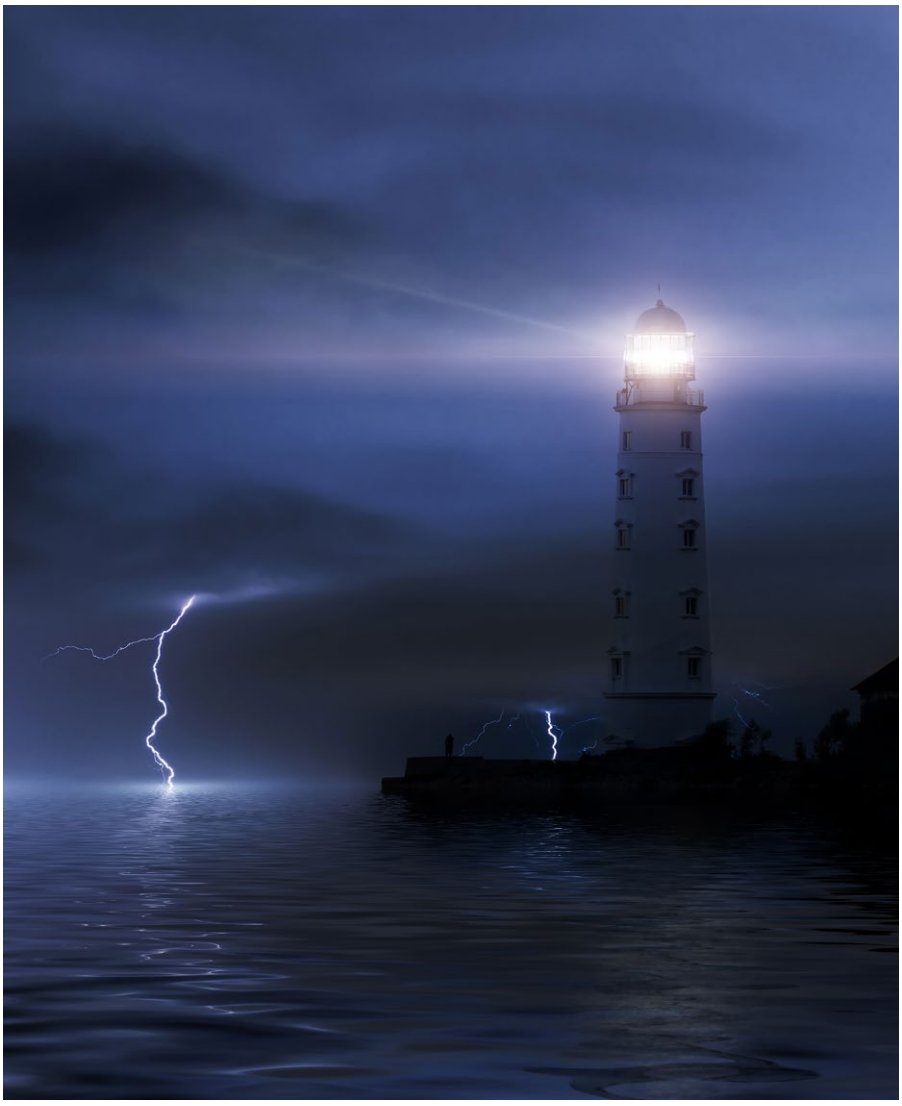
The court concluded by listing various reasons why it surmised that Madikor was commercially insolvent, ranging from its failure to make payments in terms of various agreements, to its own admissions regarding its financial predicament, with the inclusion of the application for its business rescue. The final liquidation order was accordingly granted, and the gates of the case could finally be closed.

This case is a prime example that the court will not allow for any abuse of process in order to avoid a company's monetary obligations to its creditors, specifically secured creditors. The court will not be clouded by any disingenuous and colluded means of avoiding contractual duties and any action to this effect will be swiftly set aside.

Lucinde Rhoodie
Director

Ngeti Dlamini
Associate

Kara Meiring
Candidate Attorney



OUR TEAM

For more information about our Business Rescue, Restructuring & Insolvency sector and services, please contact:

Tobie Jordaan
Director
Dispute Resolution
T +27 (0)11 562 1356
E tobie.jordaan@cdhlegal.com

Thabile Fuhrmann
Chairperson
Director
Dispute Resolution
T +27 (0)11 562 1331
E thabile.fuhrmann@cdhlegal.com

Richard Marcus
Director
Dispute Resolution
T +27 (0)21 481 6396
E richard.marcus@cdhlegal.com

Kgosi Nkaiseng
Director
Dispute Resolution
T +27 (0)11 562 1864
E kgosi.nkaiseng@cdhlegal.com

Mongezi Mpahlwa
Director
Dispute Resolution
T +27 (0)11 562 1476
E mongezi.mpahlwa@cdhlegal.com

Lucinde Rhoodie
Director
Dispute Resolution
T +27 (0)21 405 6080
E lucinde.rhoodie@cdhlegal.com

Belinda Scriba
Director
Dispute Resolution
T +27 (0)21 405 6139
E belinda.scriba@cdhlegal.com

Andrew MacPherson
Senior Associate
Dispute Resolution
T +27 (0)21 481 6359
E andrew.macpherson@cdhlegal.com

Pauline Manaka
Senior Associate
Dispute Resolution
T +27 (0)21 481 6395
E pauline.manaka@cdhlegal.com

Vincent Manko
Senior Associate
Dispute Resolution
T +27 (0)11 562 1660
E vincent.manko@cdhlegal.com

Kylene Weyers
Senior Associate
Dispute Resolution
T +27 (0)11 562 1118
E kylene.weyers@cdhlegal.com

Ngeti Dlamini
Associate
Dispute Resolution
T +27 (0)21 481 6474
E ngeti.dlamini@cdhlegal.com

Courtney Jones
Associate
Dispute Resolution
T +27 (0)11 562 1731
E courtney.jones@cdhlegal.com

Johanna Lubuma
Associate
Dispute Resolution
T +27 (0)11 562 1735
E johanna.lubuma@cdhlegal.com

Stephan Venter
Associate
Dispute Resolution
T +27 (0)11 562 1750
E stephan.venter@cdhlegal.com

Jessica Osmond
Candidate Associate
Dispute Resolution
T +27 (0)11 562 1067
E jessica.osmond@cdhlegal.com

JOHANNESBURG
1 Protea Place, Sandton, Johannesburg, 2196. Private Bag X40, Benmore, 2010, South Africa. Dx 154 Randburg and Dx 42 Johannesburg.
T +27 (0)11 562 1000 F +27 (0)11 562 1111 E jhb@cdhlegal.com

CAPE TOWN
11 Buitengracht Street, Cape Town, 8001. PO Box 695, Cape Town, 8000, South Africa. Dx 5 Cape Town.
T +27 (0)21 481 6300 F +27 (0)21 481 6388 E ctn@cdhlegal.com

STELLENBOSCH
14 Louw Street, Stellenbosch Central, Stellenbosch, 7600.
T +27 (0)21 481 6400 E cdhstellenbosch@cdhlegal.com