

BUSINESS RESCUE, RESTRUCTURING & INSOLVENCY NEWSLETTER



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Business Rescue,
Restructuring &
Insolvency

As I write, my inbox is brimming with updates on COVID-19. The first week of lockdown is almost over and it appears that everyone has become accustomed to social distancing, working from home and travel bans.

It goes without saying that South Africa is entering an unprecedented period of uncertainty brought on by the national lockdown. It is important to remember that while we all need to stay at home to protect our fellow citizens (and by implication, ourselves), we also need to look ahead.

For some, the current lockdown, with an option of it being extended, has further added to fears of salary cuts and possible business failure. In the first week we have already heard that the Business Rescue Practitioners of SA Express have filed for liquidation and we have all listened to the emotional recording of the conference call between Edcon's CEO and the company's suppliers. Furthermore, South Africa's sovereign credit rating was downgraded to sub-investment grade, or "junk status", by Moody's – the last ratings agency of the big three rating agencies to do so.

To help you navigate the current uncertainty surrounding the outbreak, we have launched this newsletter to keep you up to date on the possible impact on your business and the economy. We will cover topics relating to, *inter alia*, financial distress, directors' liability, business rescue and liquidation.

We kick off this edition with a guide on how to prepare your business for COVID-19 and we have set out certain essential steps to be taken by businesses in financial distress. We have

also included a write-up on a recent judgment dealing with the ranking of creditors in business rescue proceedings.

Only time will tell if we can expect certain amendments to the current legislation which will bring about some much-needed relief measures. Thus far we have seen the Companies and Intellectual Property Commission taking the first step by announcing that it will not invoke its powers in terms of section 22 of the Companies Act where a company is temporarily insolvent and still carrying on business or trading. These powers allow the Commission to issue notices where it believes that a company is trading recklessly. The aforesaid accession will only be applicable if the company's insolvency is due to business conditions which were caused by COVID-19 and will lapse within a period of 60 days after the declaration of a national disaster in South Africa has been lifted.

We agree with our President that "there are many amongst us who are fearful, uncertain and vulnerable". Rest assured, the business rescue and insolvency specialists at CDH remain available to assist and guide you through these unprecedented and challenging times.

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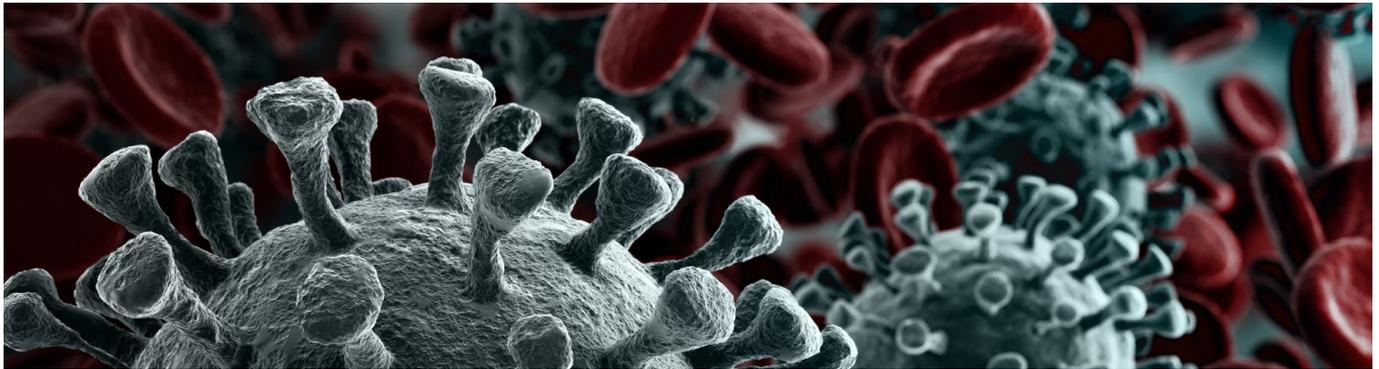


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Preparing your business for COVID-19 and essential key points for businesses in financial distress



South Africa and the world at large are presently being rocked by the COVID-19 pandemic. One of the hardest hitting consequences of COVID-19 are on businesses throughout South Africa, particularly following the national lockdown put in place by the South African government.

Many businesses are suffering financially, with revenues dropping sharply until such time as the virus is contained, restrictions are uplifted and life returns back to normal.

The implications of COVID-19 will cause severe financial distress for many businesses if a proper plan is not set in place to navigate a way to restructure their affairs.

Here are nine key points that are important to consider in working through these challenging times:

Take a reality check

Are you already in financial distress? This may be a tough reality to face, but it is an essential starting point. Many businesses in financial distress are in denial. They stop looking at their bills and stop reading angry emails from creditors.

The first step is admitting that your business may be in trouble and that something needs to be done.

Acknowledging your situation, looking it squarely in the face, and taking action is infinitely preferable to putting your head in the sand.

Ensure that your books and records are up to date

It is essential that you determine your business' financial position, and in particular the extent of your assets, liabilities and monthly expenses.

You need to know who your creditors are, what you owe them and when the amounts owing will fall due. You also need to check who your debtors are, what they owe you and when they are going to be able to pay you.

Do the insolvency and liquidity test and determine if you are financially distressed

The Companies Act 71 of 2008 provides many helpful tools for directors to apply in these challenging times.

A company satisfies the solvency and liquidity test at a particular time if, the assets of the company (fairly valued) equal or exceed the liabilities of the company (fairly valued); and it appears that the company will be able to pay its debts as they become due in the ordinary course of

business. Directors would need to consider the company's financial information and financial statements.

If it appears to be reasonably unlikely that you will not be able to pay all of your debts as they become due and payable within the immediately ensuing six months, then you are financially distressed.

These tests must be applied more carefully and prudently, especially now. If your company is financially distressed or if it does not pass the solvency and liquidity test, it is crucial that steps be taken to restructure its affairs.

Talk to your insurer

Business Interruption cover is an important insurance offering in both short- and long-term insurance for businesses. Consult with your broker and/or insurer to check whether you are covered under your insurance policy.

If you are not, this gives you the opportunity to address the lack of appropriate cover in order to mitigate the potentially disastrous results a pandemic such as COVID-19 or other similar infectious disease could have on your business in the future.

Talk to your suppliers, creditors and customers

Have an open and honest discussion with your suppliers and creditors and see if you can work out an agreement on the best way forward. Most people are willing to work with you if they believe that you will eventually pay what you owe. Keep the

Preparing your business for COVID-19 and essential key points for businesses in financial distress...continued

lines of communication open. If you are not transparent with major creditors, the environment may become hostile.

It is also important to concentrate your efforts on your business' best customers. Focusing on your most reliable, profitable customers can be an effective method of improving your cash-flow.

It is important to gain the support of your bank by being open and transparent about the situation you are in. If you proactively approach your bank with a sound plan to improve your financial situation and repay that loan, the bank is likely to work with you.

It is also in the bank's best interest to have you work through these challenging times so that you remain a customer in the long-term.

Call in outstanding debts

It is often the case that businesses allow outstanding debts to go unpaid for significant periods of time, potentially resulting in cash-flow problems. A growth in accounts receivable is a common cause of a company's insolvency issues.

One way to deal with late payments is to contact your debtors with a reminder notice. If they still fail to pay, consider handing over the debt for formal collection. In future, you could offer early payment discounts to increase the flow of cash into the company.

Cut costs

Many businesses experience cash-flow problems due to excessive spending. This can be on salaries, equipment, marketing or other operating costs. One way to increase cash-flow is to cut costs and reduce unnecessary spending. This may mean disposing of non-key assets, letting go of staff or cutting the marketing spend.

Make a list of all your expenses on a spreadsheet and go through it carefully (with your accountant if necessary). How much can you save and where? You could consider creating a document called a 'break even analysis' which tells you the minimum sales level required in order not to sustain a financial loss.



Your mental health is important

It is a very stressful experience to have a business in financial distress and it can take a personal toll on you. During these tumultuous times, it is important that you look after your emotional, psychological and social well-being, as it affects how we think, feel, and act. It also helps determine how we handle stress, relate to others, and make choices in our businesses.

Chat to your doctor or mental health professionals if you are in need of help.

Get help from insolvency specialists

You may be considering your options and wrestling with the survival of your business. Getting qualified help is likely to save you money and also your business in the long run.

If you think your business is in financial distress and you need some help with a plan of action, then our team at CDH are the best people to talk to. Our team are experienced specialists in business rescue, restructuring and insolvency law. We would be happy to have an initial consultation with you to help you understand your business' financial position and what options you have available going forward (for the duration of the lock down period, all consultations will be conducted online). We can and want to help you during these trying times.

Kylene Weyers
Senior Associate

Take a number: The status of employees' claims to remuneration in business rescue proceedings

Business Rescue, introduced by Chapter 6 of the new Companies Act 71 of 2008 (the Act), is an innovation with profound implications. It aims to place a financially distressed company temporarily in intensive care with the sole objective of trying to rescue it, or put the company on a footing where there is a reasonable prospect that it could be rescued. It sets out a procedure whereby the company can either be restructured in order to continue running on a solvent basis, or for a business rescue plan to be developed that would result in a better return for shareholders and creditors than would result from the immediate liquidation of the company. Our courts are regularly called upon to consider and give meaning to Chapter 6, in particular the interplay between sections set out in Chapter 6 and the weighing up of rights of different stakeholders.

One such aspect is the interaction between section 135 of the Act, dealing with the ranking of creditors in business rescue proceedings, and section 134(3), dealing with the rights of pre-business rescue secured creditors. In the recent case of *NUMSA v VR Laser Services (Pty) Ltd (19419/19) [2020] ZAGPJHC 47*, the Gauteng High Court provided some much-needed clarity on this interaction.

Summary of the facts

After a series of unfortunate events, including the eventual loss of access to banking facilities, the Gupta owned company, VR Laser Service, was placed into business rescue. In line with the provisions of the Act, two business rescue practitioners (practitioners) were appointed to salvage the situation. Apart from putting together several business rescue proposals, the practitioners also urged all service providers and employees to continue rendering services, notwithstanding the fact that they would not be paid immediately. The promise was made by the practitioners that their remuneration would form part of post commencement financing (PCF) and as such would carry preferential weight in terms of section 135 of the Act.

More than two months passed, and no business rescue plan had been agreed on. Furthermore, the employees of VR Laser had not been paid, but since they were technically still employed, they could not receive unemployment benefits either. Eventually the practitioners proposed a fourth

and final plan, which provided creditors with the option to either vote for a "controlled liquidation" of the company, that would be overseen by the practitioners, or a "court ordered liquidation" in terms of the Act.

The practitioners made it clear that the first option was more beneficial, since a court ordered liquidation would result in employees being dismissed and potentially losing out on their claims against the company (they failed to mention that a "controlled liquidation" would have the exact same outcome). Needless to say, the majority of creditors voted for "controlled liquidation" and two weeks later the practitioners terminated the services of all employees. It is worth noting that "controlled liquidation" was never an option lawfully available to the practitioners (in terms of the Act or otherwise), since once liquidation proceedings commence, there can be no business rescue and the services of the practitioners are no longer required.

In an attempt to satisfy the debts owed by VR Laser Services, the practitioners subsequently auctioned off certain assets over which the Bank of Baroda (the Bank) (as a pre-business rescue creditor) held security. The proceeds of the sale amounted to approximately R32 million, of which R29,5 million was owed to the Bank.

The practitioners, without notifying the other creditors, intended to use these proceeds to fully liquidate the debt owed to the Bank. The employees, represented by NUMSA (the first applicant in the matter),

discovered this intention and urgently wrote to the practitioners urging them not to pay the Bank. The employees contended that their claim ranks above that of the Bank and relied on the court's interpretation of section 135 of the Act in the case of *Redpath Mining South Africa v Marsden NO and others (2013)*, which states that claims rank as follows:

1. The practitioner, for remuneration and expenses.
2. Employees for any remuneration which became due and payable after business rescue i.e. the PCF.
3. Secured lenders/creditors - after business rescue proceedings began.
4. Unsecured lenders/creditors - supply made after business rescue proceedings began.
5. Secured lenders/creditors for any loan or supply made before business rescue proceedings began.
6. Employees remuneration before business rescue proceedings began.
7. Unsecured lenders or other creditors for any loan or supply made before business rescue proceedings began.

NUMSA applied to court for a declaratory order that the claims of the employees, which accrued post business rescue, rank above that of the Bank and that the proceeds of the sale of the secured assets should be used to settle the money owed to the employees as PCF.



Take a number: The status of employees' claims to remuneration in business rescue proceedings...continued

The Court's findings

On the facts before it, the court was required to determine whether the proceeds from the sale of the assets over which the Bank held security, as a pre-business rescue secured creditor, may be used to settle the PCF debt owed to employees, and consequently whether these claims rank above that of the Bank.

The court did not disagree with the ranking of claims set out in section 135, but rather turned its attention to section 134(3) of the Act, which deals with the sale of secured assets during business rescue proceedings.

The section determines that when a secured asset is sold, the creditor in whose favour the security was held, is fully entitled to the proceeds of the sale. It differs from security in terms of section 135(2)(a), which security only arises after the commencement of business rescue proceedings.

The court held that "[t]he provision is robust and firm. Leaving no room for doubt, the legislature has made crystal clear its intention" and highlights the fact that the protection granted by section 134 to a pre-business rescue secured creditor

is all encompassing, protecting it against "all eventualities". It quoted as authority the Supreme Court of Appeal in *Diener v Minister of Justice* 2018 (2) SA 399 (SCA) where it held that business rescue proceedings should not be seen as diluting or undermining security in any way.

Therefore, the order of claims set out in section 135 does not affect the workings of section 134(3) and does not diminish the protection provided thereby. The court accordingly dismissed the application.

Conclusion

This judgment has made it abundantly clear that preferential ranking of employees' claims in section 135 of the Act in business rescue proceedings is only enforceable to a certain extent and is limited by the security of section 134. Essentially, assets that had been secured prior to the commencement of business rescue proceedings cannot be used to satisfy the claims of PCF creditors, unless the creditors in whose favor the assets were secured, had been paid in full.

Apart from providing clarity on the interaction of the above sections, this case also highlights the potential dangers of

business rescue practitioners being left unchecked. In setting out its judgment, the court is clearly alert to the irresponsible and unlawful way in which the practitioners were found to have carried out the business rescue proceedings in this matter. The court even goes as far to record the reckless behavior of the practitioners in its judgment, although it does not make a finding against them.

We hope that all business rescue practitioners will take heed of this judgment and ensure that they properly and lawfully carry out their duties in accordance with the provisions of Chapter 6 of the Act. Creditors should keep in mind that should they believe that the appointed practitioner is acting in contravention of the Act in carrying out his/her duties, they can apply to court to have the practitioner removed and a new practitioner appointed.

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CHAMBERS GLOBAL 2017 - 2020 ranked our Dispute Resolution practice in Band 1: Dispute Resolution.

CHAMBERS GLOBAL 2017 - 2020 ranked our Dispute Resolution practice in Band 2: Restructuring/Insolvency.

Tobie Jordaan ranked by CHAMBERS GLOBAL 2020 as an up and coming Restructuring/Insolvency lawyer.



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