DISPUTE RESOLUTION

BUSINESS RESCUE, RESTRUCTURING & INSOLVENCY

NEWSLETTER

Volume 17 | 12 March 2021

CDH
CLIFFE DEKKER HOFMEYR

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Business Rescue,
Restructuring &
Insolvency

Don't raise a glass for level 1, we still have lots more to do

As we usher in our second level 1 lockdown, we once again find ourselves hopeful that we will be able to frequent our usual after-work (from home) spots to socialise with our friends well into Friday night (that is, until 12am). However, the sobering reality remains that COVID-19 and its oft-recited devastating social and economic consequences remain our daily reality; as revenue streams continue to remain low, while overhead costs remain fixed for most industries.

In this month's edition of our newsletter, we will be considering the need for companies in the tourism and hospitality industry, in particular, to start considering business rescue as a means to start recouping the R70 billion loss which they sustained during the hard lockdown alone. Hopefully business rescue will successfully be used in the industry so that we can see a recovery of the businesses in the industry, and still book those trips we've been eyeing out since March 2020. Additionally, if COVID-19's continued existence hasn't sobered you up yet, Finance Minister Tito Mboweni will as he increases sin taxes by an average of 8%.

In other business rescue news, it seems like SAA is gearing towards being able to fly us to our post-pandemic travel destinations as Pravin Gordhan announced that Government has identified three potential equity partners to assist with getting the failing airline out of business rescue. But the airline, like the rest of us, remains grounded by COVID-19 as it further delays the date for the recommencement of its flights to 30 April.

It seems like property groups are also having to further adapt to the economic circumstances presented by COVID-19, as groups such as Hyprop Investments have been forced to implement lower increases in rent for leases that are being renewed by tenants who are understandably reluctant to commit to expensive long-term leases at the moment. This has resulted in an overall reduction in rental incomes, but this outcome is better than increases in vacancies where tenants opt to entirely abandon the renewal of their leases. It appears to be a tenants' market at the moment, as the overriding conditions are providing them with strong bargaining chips in negotiations with their landlords regarding their lease renewals.

In insolvency news, the risks of cryptocurrency investment schemes have come to the fore as the Western Cape High Court postponed the final liquidation hearing for Mirror Trading International (MTI). MTI was a network marketing scam that claimed to offer automated trading services in cryptocurrency. MTI has been declared "*the biggest cryptocurrency scam of 2020*", as more than 280 000 investors are queuing for the return of their money pursuant to MTI's collapse in September of last year. There are three groups opposing the liquidation on the basis that the company instead be placed in business rescue or undertake a section 155 compromise. We await to see whether the facts of this case have made out a good case for a final liquidation.

All in all, we have seen yet another eventful month in the insolvency, restructuring and business rescue sector as we continue to observe how industries and companies are adapting to the overriding economic circumstances.

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Level 1 isn't going to save the tourism and hospitality industry, business rescue is

It has been reported that the SA tourism industry lost R70 billion in revenue and upwards of 300,000 jobs in the hard lockdown alone, with the South African fiscus ultimately having likely lost a potential contribution of R220 billion by the industry to the country's gross domestic profit as 50,000 tourism businesses have either temporarily or permanently closed. While under the newly eased Level 1 Lockdown restrictions venues are now permitted to accommodate more people, curfew is later and alcohol is more freely available - the negative impact of COVID-19 and the resultant lockdowns continue to be felt by the tourism and hospitality industry, as overhead costs remain fixed while revenue streams continue to stay low.

However, ensuring that this industry survives beyond the COVID-19 pandemic is crucial for South Africa's economic and social wellbeing; as employees will be able to keep their jobs in the long-term, and travelers will finally be able to book those trips they have been eyeing out for months now. For many companies within the industry, the time for considering the restructuring of its debts or rescue mechanisms has already come (if not passed).

Although Government has admirably launched initiatives such as the Tourism Equity Fund (TEF) to assist with boosting the industry, tourism and hospitality companies must recognise that these initiatives are in themselves insufficient to successfully save their businesses. Business rescue proceedings, being the legal mechanism found in Chapter 6 of the Companies Act 71 of 2008 (Act), may potentially provide the adequate necessary relief which could allow companies in the industry to survive the COVID-19 pandemic and capitalise on the post-pandemic opportunities which lie ahead.

Level 1 isn't going to save the tourism and hospitality industry, business rescue is....*continued*

The benefits and relief provided by business rescue

Due to the uncertainty within the tourism and hospitality industry caused by our fluctuating levels of lockdown, many companies are hopelessly still holding onto the possibility that business will improve without them having to consider intervening measures such as business rescue. But the numbers speak for themselves. Even if we were to proceed on the perhaps misguided assumption that we will remain in level 1 lockdown until the end of the national state of disaster, the losses that have already been incurred by companies in the industry cannot be remedied in the absence of immediate proactive intervention.

Undoubtedly, many of these companies are already facing claims for outstanding rent, salaries and/or mortgage repayments. If left unchecked, these claims could culminate in legal proceedings being instituted against the companies for the payment of these amounts. The walls are starting to close in on these companies, and business rescue is arguably the key for them to temporarily escape and get some breathing space to allow the business to return to a state of solvency.

The legal consequences of being placed in business rescue, and which provide this breathing space, can be summarised as follows:

- No legal proceedings, including enforcement action, can be instituted, or continued against the company, or in relation to any property belonging to the company or in its lawful possession. This is made possible by way of the imposition of a moratorium as provided for in terms of section 133 of the Act, allowing the business the freedom to restructure and rehabilitate without fear or hinderance of creditors or stakeholders instituting legal proceedings against it.

- No one will be able to exercise any right in connection to property in the lawful possession of the company, irrespective of whether the company is the owner of the property, unless the business rescue practitioner has given their written consent. This is in accordance with section 134 of the Act. Accordingly, the company will be able to keep assets which it requires to continue business.
- The company's employees will continue to be employed on the same terms and conditions, unless: (i) changes occur in the ordinary course of attrition; or, (ii) the employees and the company agreeing different terms. This provision gives companies, acting through their business rescue practitioner, the scope to cut their employee overheads by renegotiating their employment contracts.
- The business rescue practitioner is empowered to either suspend or, on application to a court, cancel any contractual obligations which would otherwise become due by the company during the course of the business rescue proceedings in terms of section 136(2) of the Act.

Level 1 isn't going to save the tourism and hospitality industry, business rescue is....*continued*

The TEF

Whilst funding from Governmental initiative such as the TEF can assist in starting to recoup the losses sustained by companies in the industry, it must be remembered that their prescribed qualifying criteria is aimed at a very niche sector of the market. The turnaround time for obtaining this funding will likely also be quite long due to the complexity of the application process.

Accordingly, the funding will only be available at a much later stage, if at all for those not meeting the requirements. Whilst companies are encouraged to pursue applications for this sort of funding, they should not wait around to find out whether their application has been successful, and to be paid, before they take additional steps towards saving themselves. They should instead view these initiatives such as being supplementary (and not the sole) measures to assist with saving their businesses.

Business rescue in the tourism and hospitality industry: reputation is everything

The reputation of a company providing tourism and hospitality services is of paramount importance to its continued survival and success. Although there has historically been a perception that being placed into business rescue creates reputational harm for a business, companies must understand that in the current circumstances business rescue actually provides a means of maintaining its reputation. In light of the continued restrictions on the operations of businesses in tourism and hospitality industry, their customers are more readily understanding of the need for them to be placed under business rescue in order to survive these challenging and uncertain times.

Additionally, companies providing tourism and hospitality services are also in possession of deposits paid by customers in anticipation of their future travels or events. Should these companies go into liquidation, then these deposits will fall into the insolvent estate to be distributed amongst all their creditors (including their employees, further service providers etc.). Should they opt to pay these deposits back to their customers and then go into liquidation, they run the risk of the company's liquidators claiming these deposits back from the customers on the basis that the payments were made at a time that the company knew it was in a financially distressed position and had the effect of preferring one class of the company's creditors (being its customers) over and to the detriment of its others. If either of these scenarios were to occur as a result of allowing the company to descend into liquidation, not only would this have major reputational risks, but further, the directors of these companies could face liability not only in their capacity as directors in terms of section 77 of the Act, but also in their personal capacity in accordance with section 22 of the Act.

By contrast, business rescue provides a way for these directors to avoid the above damning scenarios and an opportunity to act in the best interests of the company and avoid the company trading in reckless circumstances, as the election of business rescue gives the company breathing space to rearrange its affairs. By failing to promptly pursue this opportunity, not only do the directors jeopardize the continued existence of their companies but they also jeopardize their reputation as vendors in the tourism and hospitality industry.

Personal liability of directors trading recklessly

Other than the practical benefits of saving one's company and maintaining your business reputation, directors should also bear in mind that they run the risk of being held personally liable.

Should directors fail to place a company into business rescue and continue to trade in circumstances where they know the company is in financial distress, then they could later be found to have traded recklessly. If this is the case, they may be held personally liable for the losses sustained during the period in which they opted to continue trading instead of placing the company into business rescue.

Conclusion

There are accordingly very real reputational and legal risks posed to directors who decide to continue operating on the false hope that business will improve, as opposed to taking timeous intervention by placing the company into business rescue. There are similarly very real benefits to the business rescue process which can help these companies survive.

Directors of companies in the tourism and hospitality industry should therefore avoid idly holding onto hopes of an uptick in business, and are encouraged to seek immediate legal advice in order to determine whether business rescue is the appropriate legal mechanism for helping save their business and avoiding the aforementioned risks.

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Take two: Perfection of general notarial bonds and business rescue

The impact of the ongoing pandemic on the economy is yet to be fully explored, but there is no doubt it will certainly further deepen South Africa's downturn woes and potentially push it into a deep recession. Many companies (and close corporations) in distress have or are contemplating a restructuring of some sort, including business rescue. In the case of business rescue proceedings, the timing of the perfection of general notarial bonds (GNBs) becomes very critical for creditors and bondholders. In our previous Dispute Resolution Alert, we dealt with the enforcement of GNBs in general. In this newsletter, we consider the perfection of GNB's in business rescue.

Perfection of GNB's before business rescue

Where a creditor has reason to believe that a debtor company is in severe financial distress and that the company may be placed in business rescue, either by means of the passing of a resolution by the board of the company or by court application issued by an affected person, creditors often find themselves in a race against time to perfect their GNBs before the company is placed in business rescue. Perfection prior to business rescue is most certainly the best possible scenario for a creditor as this affords the creditor a real right over the movable assets of the company. Once business rescue proceedings commence, the creditor will be treated as a secured creditor and will have some leverage over the manner in which the appointed business rescue practitioner (BRP) deals with the movable assets of the company.

As noted in the above alert, perfection of a GNB entails a successful application to the High Court for an order that such property be attached and actual possession of the property is obtained usually by the sheriff of the High Court. Even though there is limited authority for the view that perfection applications are by their nature urgent, this proposition has not yet been universally embraced by the bench and the court process does not always allow for the desired speed.

For example, despite the fact that creditors are, as a matter of course, entitled to approach the court on an urgent basis to perfect their securities, the current practice, at least in the Gauteng Division of the High Court, is that the normal time for the bringing of an urgent application is at 10h00 on the Tuesday of the motion court week unless there is extreme urgency. An applicant must establish urgency and the

Take two: Perfection of general notarial bonds and business rescue....*continued*

urgency must be to such a degree that the court is prepared to allow for a relaxation in respect of the normal requirements. In this case, imminent business rescue is an issue that will need to be evaluated and weighed by the court.

It is therefore not inconceivable that a company may be placed in business rescue, either by resolution or court order (subject to similar urgency restrictions set out above), while the perfection application is pending. The court process therefore comes with its own challenges as far as timing is concerned.

As the court process does not always allow for speed, there are instances where a creditor may be able to perfect its GNB by agreement with the debtor company prior to the commencement of business rescue proceedings and in so doing front run and/or circumvent the court process to obtain a perfection order altogether. This may however pose some risks for creditors as other creditors, particularly preferent creditors such as the South African Revenue Services that would otherwise rank above a creditor with an unperfected GNB under the Laws of Insolvency, may seek to challenge the consensual perfection.

Perfection of GNB's during business rescue

Section 133 of the Companies Act, 2008 (Companies Act) places a general moratorium on legal proceedings against the company while the company is in business rescue. That section states that no legal proceedings, including enforcement action against the company or in relation to any property belonging to the company or lawfully in its possession may be commenced with, save in certain exceptions, for example where consent is granted by the court or obtained from the BRP.

Creditors may therefore approach the BRP at any time after the commencement of business rescue proceedings for written consent to allow the perfection of a GNB. However, it is often the case that the BRP will refuse to grant their consent and/or will most likely oppose the granting of such consent by a court as the perfection of a GNB will *inter alia*, (a) restrict the BRP's use of the movable assets, (b) discourage the granting of any post-commencement finance (PCF) and (c) diminish the prospect of a successful business rescue.

A creditor may also consider protecting its rights by placing reliance on the provisions of section 134(3) of the Companies Act. That section states that if, during a company's business rescue proceedings, the company wishes to dispose of any property over which another person has any *"security or title interest"*, the company must obtain the prior consent of that person unless the proceeds of the disposal are sufficient to fully discharge the indebtedness protected by that person's security or title interest, and provided the company promptly pays to such person the sale proceeds of the property.

A creditor may therefore argue that even its unperfected bond constitutes a *"security or title interest"* over the movable assets and accordingly seek to enforce the provisions of section 134(3). This argument does however come with its own challenges as the Companies Act does not provide a definition of *"security"* or *"title interest"* and this has resulted in some debate as to whether or not an unperfected GNB can be classified as either a *"security"* or *"title interest"*.

What we also see in practice is that BRPs are more inclined to grant their consent for a creditor to perfect its GNB in exchange for PCF. This is so because PCF can be the lifeblood of any company in business rescue and it is often a challenge for companies in distress to convince investors or lenders to advance PCF where there is a valid concern that those investors or lenders may never see a return on their investment. Therefore, there may well be scope for a creditor to perfect its GNB in business rescue but that may require some compromise in the form of advancing PCF as a *quid pro quo*.

Concluding Observations

The timing aspect of perfecting a GNB in the face of a business rescue is quite critical in ensuring that the rights of a creditor are sufficiently protected. However, even in a situation where the creditor was not quick enough off the marks to perfect its GNB it is important for the creditor to quickly seek guidance and identify alternative avenues to enforce its security and protect its rights.

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BBBEE STATUS: LEVEL TWO CONTRIBUTOR
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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