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DISPUTE RESOLUTION
ALERT

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Converting the liquidation of Mirror Trading International (MTI) into business rescue: Is there method to this madness?

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Following the collapse of Mirror Trading International (MTI/the Company) in September 2020, after its investors realised that it was a multi-level marketing scheme, it was generally assumed that the Company would simply be liquidated so that its investors could start recouping their losses. However, in a surprising turn of events, the hearing of the application for MTI's final liquidation was postponed when three opposing groups approached the High Court of South Africa, Western Cape Division (court) asking for further time to explore the possibility of placing the Company into business rescue. In this alert, we consider whether business rescue is a viable alternative to liquidation, considering the unique circumstances of MTI.

Background

MTI presented itself as an automated bitcoin trading platform; where users would simply deposit a prescribed minimum amount of Bitcoin into its wallet, and MTI would then grow it using an AI-powered foreign exchange trading software (Trading Bot). MTI incentivised users to invest by advertising its Trading Bot as yielding growth in members' Bitcoin of 0.5% to 1.5% per day, and that users would receive even greater returns if they referred further users to invest. On this basis, MTI accumulated billions of rand worth of Bitcoin during 2019 and 2020.

Then, following an investigation by the Financial Sector Conduct Authority (FSCA) and exposing data leak by Anonymous ZA, it was revealed that MTI was a multi-level marketing scheme which did not have enough assets to cover its obligations. In other words, MTI could not make good on its extraordinary promises to its investors as it simply did not have enough Bitcoin to repay them their initial Bitcoin investments plus the promised growth thereof, if demanded to do so. As a result, the Company was placed into provisional liquidation.

It is important to note that MTI only accepted deposits in Bitcoin, and not their value equivalent in cash. Investors accordingly had to purchase Bitcoin using a crypto-exchange platform such as Luno, for example, and then had to invest it with MTI by transferring it into a digital wallet controlled by MTI.

What is Bitcoin?

In order to understand MTI's unique circumstances better, lets first look at what Bitcoin is. Bitcoin is a 'digital currency', which is decentralised in the sense that it is not controlled by any centralised entity, such as a bank, but instead directly transferred between consumers using something called the 'blockchain'. The blockchain is essentially a public digital record of transactions made with cryptocurrencies, such as Bitcoin. It records the details of every Bitcoin transaction ever made and automatically rejects any transaction which does not conform to its records. A user is therefore prevented from fraudulently using the same Bitcoin for multiple transactions, as the blockchain will reject such transaction on the basis that its records reflect that

Converting the liquidation of Mirror Trading International (MTI) into business rescue: Is there method to this madness?*...continued*

Because of the lack of central administration or regulation of cryptocurrencies such as Bitcoin, they have not yet been recognised as a fiat currency.

the Bitcoin has already been transferred. In this way, the integrity of transactions is maintained without the need for the oversight by a centralised intermediary.

Each consumer's Bitcoin is stored in a cryptocurrency wallet, which is only accessible through a unique and private alphanumeric key. In MTI's case, the key to the wallet containing the thousands of Bitcoins invested into MTI is suspected to be missing along with its erstwhile CEO.

Because of the lack of central administration or regulation of cryptocurrencies such as Bitcoin, they have not yet been recognised as a fiat currency. They are instead considered to be an asset (cryptoasset) which is subject to drastic price fluctuations, as their value is dependant on public trust and perception. Many accordingly brand them as a speculative investment.

Does the presence of cryptoassets in MTI's estate support a case for business rescue, as opposed to liquidation?

Cases such as that of MTI reflect the new reality that insolvent estates may contain cryptoassets, presenting an unchartered set of legal complexities for business rescue and insolvency law. Issues such as the choice between business rescue and liquidation proceedings are brought under a new light, as legal practitioners are tasked with determining how to manage this relatively new and unique type of asset in a way that best balances the rights of all stakeholders.

Turning to MTI, one has to bear the respective purposes of business rescue and liquidation proceedings in mind when considering which would be the more appropriate route for the ultimate purpose of providing the best outcome for the creditors.

Converting the liquidation of Mirror Trading International (MTI) into business rescue: Is there method to this madness?*...continued*

Since it appears that MTI's business model was unrealistic, it would seem that the above first mentioned goal of business rescue will in all likelihood not be achievable under the current circumstances.

The purpose of liquidation proceedings is to realise and dispose of the assets of the insolvent company, for cash, and pay whatever proceeds might become available to the creditors of the company by means of a legal order of preference.

On the other hand, section 128(1)(b)(iii) of the Companies Act 71 of 2008 (2008 Companies Act) provides that the goal of business rescue is to restructure the affairs of the insolvent company so that it can either:

- continue to operate on a solvent basis; or
- if that is not possible, result in a better return to creditors than would otherwise have resulted from the company's immediate liquidation (otherwise referred to as an 'orderly wind down').

Since it appears that MTI's business model was unrealistic, it would seem that the above first mentioned goal of business rescue will in all likelihood not be achievable under the current circumstances. As for the second goal, due to the missing Bitcoin - which is likely only accessible to the erstwhile missing CEO - it is difficult to imagine what assets a business rescue practitioner (BRP) would have to work with in order to facilitate an orderly winding down of the Company which will result in a better return for the creditors than the immediate liquidation of MTI.

A further factor militating against the conclusion that business rescue would be the preferable course of action in respect of MTI is that a BRP does not have the powers afforded to liquidators in terms of sections 417 and 418 of the Companies Act 61 of 1973 (1973 Companies Act) to summon and examine persons as to the affairs of the company (known as insolvency enquiries). Such enquiries are necessary to establish the divestment of the Company's assets and obtain information to enable the liquidator (and creditors) to investigate the dealings of the Company prior to its liquidation. These enquiries further allow for the detection and investigation of possible impeachable transactions entered into by the company, with the view to setting aside such dispositions or preferences in terms of the Insolvency Act 24 of 1936 (Insolvency Act). In the mysterious circumstances surrounding MTI's missing CEO and the investors' Bitcoin, these powers may be vital in any exercise aimed at trying to recoup the losses sustained by MTI's investors; as the liquidators would have the necessary powers to find and recover further Bitcoin cryptoassets.

Conclusion

Although the MTI case has shown that cryptoassets present a variety of novel legal complexities, we are interested to see what arguments are going to be presented in favour of converting MTI's liquidation into business rescue should the group of investors pursue this route. We hope to see the court develop clearer precedent for navigating these unchartered waters.

Kgosi Nkaiseng, Stephan Venter and Joshua Geldenhuys

A kind of digital vaccine: The importance of insurance coverage for cybercrime

A number of high-profile data breaches affecting South Africans has reiterated the danger posed by the remote-working and digitalised environment we find ourselves in.

COVID-19, in and amongst all its other ramifications, has been a catalyst for digital evolution. In this context, it is important to note that the threats and vulnerabilities of the digital world are not new but have become more frequent. The Federal Bureau of Investigation (FBI) reported a 300% increase in cybercrimes in April 2020. In March 2020, ransomware attacks increased by 148%. Between February and April 2020, phishing was up 600% and, in April, Google blocked more than 18 million COVID-19-related phishing mails each day.

A number of high-profile data breaches affecting South Africans have reiterated the danger posed by the remote-working and digitalised environment we find ourselves in. Simply put, an increasing online world means heightened risk and liability for companies and organisations. The extent of the risk in the South African context may in fact have been underreported and the implementation of the Protection of Personal Information Act 4 of 2013 (the Act) will likely lead to further disclosure of cyber breaches, as the Act is embedded with a requirement to inform customers and regulators of any breach as soon as reasonably possible. The Act also makes provision for the imposition of penalties and potentially claims for damages in the event of breaches of its requirements, creating further potential liability for companies in relation to cyber breaches.

In the face of heightened risk and an increasingly regulatory legal environment, the use of standalone cyber insurance policies has become ever more important. This is largely because traditional insurance policies do not necessarily provide cover for these cyber-related risks. Despite this, most South African organisations are not adequately prepared for the growing risks of cybercrime, particularly in the current pandemic and the associated remote working environments. According to a 2020 SHA Report, only 18% of South African businesses surveyed possessed specialist cyber cover.

In a recent foreign case, the importance of specialised cyber insurance was emphasised. The Ontario Court of Appeal, the Canadian province's highest court, in a March 2021 ruling upheld an insurers refusal to defend based on policy exclusion clauses. In the case of *Family and Children's Services of Lanark, Leeds and Grenville v Co-operators General Insurance Company,* 2021 ONCA 0159, Co-operators General Insurance Company (Co-operators) denied a claim for a duty to defend Family and Children's Services of Lanark, Leeds and Grenville (FCS), a children's aid society, and Laridae Communications Inc. (Laridae) against data-related claims.

In August 2015, Laridae was instructed by FCS to conduct communication and marketing services. Less than a year later, a hacker accessed FCS' internal network and obtained a confidential report with case files and investigations of nearly 300 people. The document was subsequently shared on social media. As a result of the disclosure, a multi-million-dollar class action suit was filed against FCS.

A kind of digital vaccine: The importance of insurance coverage for cybercrime...*continued*

South African courts have yet to substantively delve into the matter of cyber insurance.

FCS and Laridae were insured by Co-operators in terms of a Commercial General Liability policy and Laridae, in addition, also in terms of a Professional Liability Policy. Both parties claimed that Co-operators owed them a duty to defend against the class action in terms of the policies.

Both policies contained data exclusion clauses, which provided that, "*There shall be no coverage under this policy in connection with any claim based on, attributable to or arising directly or indirectly from the distribution, or display of "data" by means of an Internet Website, the Internet, an Intranet, Extranet, or similar device or system designed or intended for electronic communication of "data"*". The court accordingly upheld Co-operators refusal to defend based on the policy exclusions.

South African courts have yet to substantively delve into the matter of cyber insurance. Nonetheless, it is evident that traditional insurance policies do not necessarily adequately cover cyber risk. Commercial general liability insurance is more commonly offered to protect businesses against asset damage such as property destruction, employee injury and natural disasters.

It is therefore vital for companies to assess the current risks brought about by COVID-19, particularly those associated with remote working and the current regulatory environment and establish whether they are adequately covered against potential cyber threats.

Byron O'Connor and Vaughn Rajah

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The LEGAL 500 EMEA

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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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