“Get busy living, or get busy dying”

This is one of my favourite quotes from the movie, The Shawshank Redemption.

I was recently reminded of Andy Dufresne (or even William Wallace) when I went out running on 1 May 2020. For a second, I considered replicating that iconic scene... but it wasn’t raining, and I didn’t escape from prison... or did I?

Everyone was out on the streets (and on the promenade in Cape Town) and I probably ended up getting more exercise from waving to my neighbours than from running. Simply put, it warmed my heart to see so many people with a smile on their face. Even the cyclists were greeting the runners.

How great is it to see that people are slowly but surely getting back to life before lockdown. I am taking it one day at a time and with our nanny being allowed to return to work and the luxury of being able to order food from restaurants - it looks like my marriage will survive.

The last five weeks have really zoomed by. Unfortunately, it came with more casualties being reported. COVID-19 (Coronavirus) has seen many giants stumble and fall. The closing of Associated Media Publishing is the end of an area. We also saw that SA Express was placed in liquidation and that Edcon has decided to place itself under business rescue. Has it become a game of who will be next and where is that much needed amendments to our insolvency legislation?

Since our last edition, we presented a follow-up webinar. Thank you to those who attended. Our guest speaker, Sifiso Skenjana, was incredible. Sifiso is the chief economist at IQ Business. Trust me, he is able to make economics fun. A recording of this second session can be downloaded here.

As promised, please see below, an article dealing with the interplay between insolvency and employment arrangements. In this edition we also include an overview of the various sectors which were hit by the Coronavirus pandemic as well as a discussion on a number of mechanisms available to directors and stakeholders to minimise harm to their businesses and reduce insolvency risks.

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We have all realised that getting a haircut has now become life’s next somewhat seemingly insurmountable challenge. I tried myself and failed. Luckily, the picture that you see on the newsletter was taken before lockdown. All I can say is not only was I recently reminded of Andy Dufresne, but we now also have similar hairstyles.

To all the mothers out there, happy Mother’s Day on Sunday.

Tobie Jordaan
Director

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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

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Tobie Jordaan
Director
The COVID-19 effect: Its impact on industries and how to reduce insolvency risks

This article will provide an overview of some of the industries in South Africa that are most affected by the COVID-19 pandemic, as well as a discussion on a number of mechanisms available to directors and stakeholders to minimise harm to their businesses and reduce insolvency risks. This will include a brief consideration of commercial legal procedures, policy responses as well as steps that may be taken to be proactive in protecting your business and to practice financial prudence. Many of these processes outlined below have been canvassed in greater detail in previous editions of our Business Rescue, Restructuring & Insolvency newsletter.

Industries in South Africa hardest hit by the COVID-19 pandemic

Aviation

Responses to the COVID-19 pandemic, including lockdowns and travel restrictions, have brought much of the global aviation industry to a standstill. Aviation is the only form of rapid domestic and international transport, which makes it vital for several other industries, including logistics, trade and tourism. As international airlines (such as Virgin Atlantic) consider bailout negotiations, economic models have predicted that the global aviation industry is to suffer an approximate loss of USD 150 – 230 billion in gross operating revenues. This is partly because airlines, unlike other businesses, essentially hit a revenue stream of zero overnight due to policy decisions such as lockdowns, while still having to maintain a number of fixed costs including aircraft maintenance and leases.

In South Africa, aside from strictly regulated flights designated for repatriation or essential cargo, flights have been halted and the domestic industry is expected to suffer losses in excess of R40 billion during the nationwide lockdown. A number of airlines are considering mechanisms such as business rescue, restructuring and/or liquidation, in order to facilitate either the possibility of conducting business in the future or winding-down operations (for example, South African Airways is currently in business rescue and South African Express Airways SOC Limited has just been placed into provisional liquidation).

Construction

A contracting economy and decreased government spending were factors already affecting the local construction industry prior to the pandemic. Now, the nationwide lockdown has forced many businesses to temporarily shut down. The South African Forum of Civil Engineering Contractors has estimated that the construction sector will, in terms of the rand value of fixed investment, decline by 8.7% this year, from an initial forecast decline of only 1.5%.

The sector employs close to one million people and it is predicted that due to the COVID-19 pandemic, job losses could amount to 100,000 over the next 18 months. As a labour-intensive sector, the construction industry is among those hit hardest by the Coronavirus. The sector has formed a COVID-19 Construction Rapid Response Task Team to look at the recovery of the industry post-lockdown. The Task Team has been formed at a critical time for the industry, against the backdrop of its aforementioned challenges, and has called for major interventions by stakeholders.

Transport, logistics and manufacturing

For the transportation and logistics industry, the economic outlook is slightly more layered than others. The nature of the COVID-19 lockdown is to minimise movement. For manufacturers, this has meant that all factories, warehouses and modes of transport have been forced to shut down. Vehicle manufacturing has also been put under immense pressure, with new vehicle sales statistics for March 2020 reflecting a substantial decline of 29.7% compared to March 2019 while export sales demonstrated a decrease of 21.5% compared to March 2019.

The South African automotive industry is export-oriented. China was South Africa’s seventh largest automotive trading partner in 2019, with imports of R18.6 billion. Managing tasks on the ground has become more
The COVID-19 effect: Its impact on industries and how to reduce insolvency risks...continued

difficult than ever, in an unprecedented time for the sector. The contraction of other industries during the pandemic has had a knock-on effect on this sector, as capacity will surely exceed demand at the current rate of activity. The movement of goods has continued in relation to the support of essential services, as well as the associated supply chains therein, however high-earning sectors such as mining and the automotive industry, as mentioned, are of course excluded from this.

Hospitality and tourism
The hospitality industry has also been hard hit by the COVID-19 pandemic, forcing many hotels, guest houses and tourism sites to operate with a skeleton staff and minimal-to-no guest and customer income. The industry is historically a major job creation hub for South Africa, employing over 700,000 in 2019.

Tourism was also on the rise in January and February, with 1.7% more travellers (3,091,233 individuals) passing through SA’s ports of entry and exit compared to the same period last year. To suddenly shift from this growth to complete inactivity has resulted in many companies in the industry considering and implementing measures such as restructuring, pay-cuts, retrenchments and the possibility of winding-up.

Entertainment
The COVID-19 pandemic has had a wide-ranging impact on the entertainment industry. Social distancing and travel restrictions mean that events, concerts, weddings, world tours and film sets are no longer viable activities for the foreseeable future. The Events Industry Council values the size of the global sector as large as USD 1 trillion, and estimates that, due to the pandemic, about 23% of the market has evaporated.

In South Africa, artists and organisers are prioritising a move to online events and performances in order to mitigate the impacts and reignite revenue streams. The Department of Sports, Arts and Culture as well as the National Film and Video Foundation is providing financial relief to entertainment companies or individuals who have had to cancel productions due to the pandemic.

Textile
The textile industry has had to shut down almost all operations during the five-week lockdown period. A number of retail outlets that were struggling prior to the onset of the pandemic might now be forced to wind-down operations or restructure and sell-off certain departments. In order to save costs, several major clothing retailers have also reached an agreement with landlords to pay 20% of their rental during this lockdown period. A few companies will see a spike in activity due to the need to produce Personal Protective Equipment, particularly cloth masks at an estimated demand of 100 million per month.

The industry was one of the first in South Africa to receive pay-outs from the COVID-19 relief fund run by the Unemployment Insurance Fund (the UIF). The agreement between industry stakeholders and government allows for the sector’s employees to be paid their full wages for a six-week period. The easing of lockdown restrictions from level 5 to level 4, nationally, as of 1 May 2020 should also see the resumption of a number of commercial activities in the sector.
The COVID-19 effect: Its impact on industries and how to reduce insolvency risks...continued

How to minimise damage and reduce insolvency risks during the COVID-19 pandemic

Relevant definitions

It is important to be aware of how and when a company is at risk in order to effectively address the consequences of COVID-19. A company will be financially distressed in terms of section 128(1)(f) of the Companies Act 71 of 2008 (the New Companies Act) if it appears to be reasonably unlikely that the company will be able to settle all its debts as and when they become due and payable in the ensuing six months or if its liabilities will exceed its assets within the ensuing six months.

A company is said to be insolvent if its liabilities exceed its assets (this is known as factual insolvency), or if it cannot pay its debts as and when they fall due (this is known as commercial insolvency). The latter is the more appropriate test for insolvency as companies are often factually solvent whilst unable to pay their debts due to cash-flow issues.

Directors’ liability and duties in financially distressed times

There is an onerous obligation placed on a board of directors of a company in terms of section 129(7) of the Companies Act wherein, if the board determines that a business is in fact in financial distress, they are to either adopt a resolution to commence with business rescue proceedings, alternatively, deliver a written notice to each of its creditors, employees, trade unions and shareholders, setting out, inter alia, reasons for not voluntarily commencing business rescue proceedings.

Failure to adhere to provisions as set out in the New Companies Act could result in a director being held personally liable for all the debts of a company. Section 77 of the Act speaks to this personal liability and explains that where a director knowingly carried on the business of the company recklessly or with the intent to defraud creditors or other stakeholders, he/she shall be held personally liable for any loss incurred by the company. Section 214 goes even further to provide for criminal liability for those directors at the steer of a company which is being traded recklessly.

In considering the above, should your company run into financial difficulties during this time, it would be unwise not to seek guidance in navigating through these uncertain and challenging times. All directors should be asking themselves the following two important questions: Is it reasonably unlikely that the company will be able to settle all its debts as they become due and payable in the ensuing six months? Or, is it reasonably likely that the company will become insolvent within the immediately ensuing six months? If the answer is yes to either of the above questions, then the company is financially distressed and we suggest you make contact with us as soon as possible.

Business rescue and liquidation

In light of the above, it is important to take note of legal mechanisms available to financially distressed and insolvent enterprises. Business rescue is defined in section 128(1)(b) of the new Companies Act as “proceedings to facilitate the rehabilitation of a company that is financially distressed”. The proceedings are aimed at aiding a company which is in financial distress, by allowing it to reorganise and restructure its affairs, assets, equity, debts, property and liabilities. We have comprehensively dealt with the mechanism of business rescue in edition 3 and 4 of our Business Rescue, Restructuring & Insolvency newsletter and we encourage readers to take note of its contents.

It may be that the situation is so dire that the only option left is to liquidate the company in order to prevent any further damage. The purpose of liquidation is to wind up the company’s affairs by selling the company’s assets either by way of private treaty or public auction in order to pay the costs of its winding up as well as its creditors. In South Africa, insolvent companies are liquidated in terms of Chapter 14 of the Companies Act 61 of 1973 (Old Companies Act), while solvent companies are liquidated in terms of the new Companies Act. We have ventilated the mechanism of liquidation in edition 5 of our Business Rescue, Restructuring & Insolvency newsletter and we encourage readers to take note of its contents.

Policy responses to reduce insolvency risks

A notable policy response is the provision of R30 billion made available by the UIF for COVID-19 income support to retrenched workers. It aims to assist workers who have been affected by the shutdown across several sectors of the economy to contain the spread of COVID-19. Industry-specific responses include commercial banks being exempted from the Competition Act 89 of 1998 to coordinate on measures which can be used to support business and citizens. In particular, the exemptions will allow banks to coordinate in respect of payment holidays, debt relief, limitations on asset repossession and the extension of credit lines.

The Industrial Development Corporation of South Africa has put a package together with the Department of Trade, Industry and Competition of more than R3 billion for industrial funding to address the needs of vulnerable firms and to fast-track financing for companies vital to efforts to address the coronavirus and its economic impact.

For April and May 2020 retails landlords, as previously discussed will offer relief in the form of rental discounts and interest-free rental deferments which includes rent, operating costs and parking rental but excludes all rates, taxes, utilities and insurance, which tenants will still be required to pay in full during the relief period.

On 7 April 2020, the Minister of Tourism announced that the Tourism Relief Fund is open for applications with effect from 7 April until 30 May 2020. On 24 April 2020, Finance Minister Tito Mboweni announced in his economic recovery address that the banking industry has announced measures to postpone clients’ debt repayments. Additionally, he stated that National Credit Guarantee Scheme will be available for businesses who make R300 million or less in annual revenue and that R1 billion has already been spent on medical necessities using money from the Solidarity Fund. The Minister also made mention of possible incoming loans from the World Bank, International Monetary Fund and the New Development Bank.
The COVID-19 effect: Its impact on industries and how to reduce insolvency risks...continued

The importance of being proactive

Directors and stakeholders must take ardent steps to protect their businesses and commercial interests. Now, more than ever, it is vital to ensure lines of communication are open and being efficiently used to liaise with landlords, banks, suppliers and debtors. It is hoped, and assumed, that contracting parties will be reasonable in the circumstances when it comes to performance and concessions such as payment holidays. Additionally, in line with the insolvency tests and commercial legal mechanisms outlined above, it is paramount that companies ensure all financial statements, books and records are up to date to determine a company’s financial position and assess cash flow.

Conclusion

While the above discussion may arguably paint a picture of distress and uncertainty, it is important to remain hopeful and optimistic. A reimagining of society is required, and it will be vital to capitalise on the new commercial opportunities that arise from this. Navigating this new normal can at times be a daunting process, especially in light of the current international economic strain and uncertainty surrounding the COVID-19 pandemic.

The Business Rescue, Restructuring and Insolvency team at Cliffe Dekker Hofmeyr possesses the specialist knowledge, skill and experience to guide you through the process of deciding the next step for your business. Directors and stakeholders should take note of the procedures outlined above when trying to mitigate the fallout of the current economic climate and when deciding which course of action is most appropriate in the circumstances. We are willing and able to assist in these unprecedented times.

Kgosi Nkaiseng
Director

Kylene Weyers
Senior Associate

Vaughn Rajah
Candidate Attorney
Financially distressed companies – What about the employees?

During this unprecedented time and all the repercussions that surround it, many people have found themselves in a spiral of uncertainty when it comes to the economy, the effect of economic conditions on their businesses and income, and importantly their means to earn a living – being their employment. All over the world, we have seen world leaders weighing up the value of life versus the value of a functional economy and trying to strike the right balance between the two, in order to ultimately protect the population from the virus, while at the same time ensuring that the economy does not suffer irreversible harm.

Despite the efforts of world leaders, including the South African president, it is becoming clearer by the day that this pandemic will cause thousands of businesses in South Africa to suffer financial distress, which in turn will result in many businesses filing for business rescue or liquidation. One of the questions that we get asked most when companies contemplate whether to file for business rescue or liquidation, is, what about our employees?

In this article, we will consider this question and at the same time try to answer most of the employment related questions that were posted during the first Webinar we hosted on 23 April 2020.

The effect of business rescue proceedings on employment contracts

General position

Section 136 of the Companies Act 71 of 2008 (Companies Act), which deals with the effect of business rescue on employees and contracts, states:

“(1) Despite any provision of an agreement to the contrary:
(a) during a company’s business rescue proceedings, employees of the company immediately before the beginning of those proceedings continue to be so employed on the same terms and conditions, except to the extent that –
(i) changes occur in the ordinary course of attrition; or
(ii) the employees and the company, in accordance with applicable labour laws, agree different terms and conditions; and
(b) any retrenchment of any such employees contemplated in the company’s business rescue plan is subject to section 189 and 189A of the Labour Relations Act, 1995 (Act 66 of 1995), and other applicable employment related legislation.”

Section 136 (2A) of the Companies Act further states that, despite being able to entirely, partially or conditionally suspend the company’s obligations under most contracts that were concluded by the company prior to the commencement of business rescue, a business rescue practitioner is not entitled to unilaterally suspend any provision of an employment contract.

The effects of the provisions listed above are the following:

(i) As a starting point, when business rescue proceedings commence, the employees of the company will continue to be employed on the same terms and conditions, subject to the following exceptions:
   • If changes occur in the ordinary course of attrition (e.g. through resignation for personal reasons or retirement); or
   • the employees and the company, in accordance with applicable labour laws, agree different terms and conditions.

(ii) If a business rescue plan makes provision for the retrenchment of employees, the retrenchment will be subject to section 189 and 189A of the Labour Relations Act (LRA), which are the provisions in the LRA which deal with retrenchments in the normal course.

Companies under business rescue will therefore continue to pay their employees their normal salaries and the employees will be expected to continue doing their jobs while the company is under business rescue, subject to the exceptions listed above.
Financially distressed companies – What about the employees? ...continued

Varying terms and conditions of existing employment contracts

Once parties have agreed on the material terms of an employment contract, it's terms are fixed in the sense that neither party may unilaterally vary them unless the original contract provides for a variation (as mentioned above, this will apply even if the employer company is placed under business rescue). Therefore, an employer must obtain the employees' consent to a proposed change to terms and conditions of employment.

If an employer or business rescue practitioner elects to unilaterally implement changes to the terms and conditions of employment of its employees, employees will have recourse, which may include a strike, a referral to the CCMA or a breach of contract claim. There is also a fine line between a dismissal based on the employer's operational requirements (retrenchment) in this context, and a dismissal due to an employee's refusal to accept a demand in respect of any matter of mutual interest between the employer and the employee (which may include a refusal to agree to new terms and conditions of employment). The latter dismissal is automatically unfair.

If an employer or business rescue practitioner needs to change terms and conditions of employment contracts in order for the company under business rescue to remain financially viable or to save jobs in the long run, it is essential to articulate a commercial rationale for insisting that employees accept the proposed changes. Only then can the employer, or business rescue practitioner, possibly justify the extreme sanction of dismissal if employees do not agree. The cases, which support this idea, impose a very high standard.

Section 189 and 189A procedure during business rescue

Sections 189 and 189A of the LRA regulate retrenchments and the process to be followed. It requires the consulting parties to embark on a joint-consensus seeking process and to consult on a list of prescribed topics. These topics include alternatives to dismissal as well as the operational requirements of the company.

It is important to note that the obligation to consult commences as soon as the employer, or business rescue practitioner, contemplates that employees may need to be retrenched. A decision regarding retrenchment may not be taken before the employer, or business rescue practitioner, has consulted with its employees. Should an employer contemplate dismissing a large number of employees, section 189A of the LRA imposes a mandatory consultation period of 60 days.

Consultation must be meaningful. Although the form of consultation is not prescribed, employers should, at the very least, ensure that its employees are able to engage meaningfully. Although not preferred, corporate entities may be able to embark on consultations via Teams or Zoom for example. However, employers with less skilled employees who do not have access to the necessary infrastructure to consult online, will have to think of alternative ways to engage with its workforce. This may include requiring them to nominate representatives for consultation, if no trade union or workplace forum already has that right.

What if the company under business rescue is unable to pay the employees?

Under certain circumstances, the company under business rescue might reach a stage where it is unable to pay its employees. If this happens, these employees will be regarded as creditors of the company and will have claims against the company.

It is important to take note that for purposes of the employees’ claims against the company, there is a distinction between remuneration that became due and payable before the company was placed under business rescue, and remuneration that became due and payable after the company was placed under business rescue.

Keeping the above in mind, the employees’ claims will rank as follows against other claims:

- The practitioner, for remuneration and expenses of the business rescue proceedings.
- Employees for any remuneration which became due and payable after business rescue proceedings began.
- Secured lenders or other creditors for any loan or supply after business rescue proceedings began, i.e. secured post-commencement finance.
- Unsecured lenders or other creditors for any loan or supply made before business rescue proceedings began.
- Employees for any remuneration which became due and payable before business rescue proceedings began.
- Unsecured lenders or other creditors for any loan or supply before business rescue proceedings began.

If there is no money left to pay the employees of the company under business rescue or if the company under business rescue is only able to partially pay the employees of the company, and this is set out in an approved business rescue plan, the employees of the company will not be entitled to claim the balance of their claims against the company.

The effect of liquidation on employment contracts

General position

By virtue of the transitional provisions in item 9(1) of Schedule 5 of the New Companies Act, the liquidation process of insolvent companies is still regulated by Chapter XIV of the Companies Act 61 of 1973 (Old Companies Act). Section 339 of the Old Companies Act states, that in the winding-up of a company unable to pay its debts,
Financially distressed companies – What about the employees?...continued

the provisions of the law of insolvency shall, in so far as they are applicable, be applied mutatis mutandis in respect of any matter not regulated by the Old Companies Act. In light of the aforementioned, the provisions of the Insolvency Act 24 of 1936 (Insolvency Act) will apply to the winding-up of insolvent companies.

Section 38 of the Insolvency Act, which deals with the effect of liquidation on employment contracts, provides that employment contracts are suspended from the date the provisional order of liquidation of the employer (or final order if it is granted without a provisional order) is granted. During the period of suspension, the employees are not obliged to render any services to the company and are also not entitled to receive their salaries or wages, nor do any of their employment benefits accrue to them. However, section 38(3) of the Insolvency Act states that an employee whose contract of service is suspended, is entitled to unemployment benefits in terms of section 35 of the Unemployment Insurance Act (Act 30 of 1966), from date of such suspension (subject to the provisions of that act).

Termination of employment contracts during liquidation

Section 38(4) of the Insolvency Act states, inter alia, that a liquidator can terminate the employment contracts of employees (subject to certain requirements being fulfilled). A liquidator may not terminate an employment contract, unless he/she has consulted with:

• Any person with whom the employer was required to consult by virtue of a collective agreement (as defined in section 213 of the LRA); or
• A workplace forum (as defined in section 213 of the LRA) (only if there is no collective agreement in place); or
• A registered trade union representing employees who are likely to be affected by the termination of the employment contracts (only if there is no collective agreement in place).
• A registered trade union representing employees whose contracts of service were suspended and who are likely to be affected by the termination of the employment contracts; or
• The employees whose contracts of service were suspended and who are likely to be affected by the termination of the employment contracts or their representatives nominated for that purpose (if they are not represented by a trade union).
During the consultation referred to above, the parties must aim at reaching consensus on appropriate means and ways to save the whole business or part of it by:

- the sale of whole or part of the business; or
- transferring the business as a going concern in terms of section 197A of the LRA; or
- by a scheme or compromise; or
- in any other manner.

Once the liquidator has consulted with the parties listed above, the liquidator is entitled to terminate the employment contracts of the employees, without any further requirements needing to be fulfilled.

Unless the liquidator and the employee(s) have agreed on continued employment, in view of saving whole or part of the business, all suspended employment contracts will terminate 45 days after the date of appointment of the liquidator in terms of section 375 of the Old Companies Act.

**Claims that employees will have against the company**

An employee whose contract was suspended or terminated, is entitled to compensation from the company under liquidation for losses suffered by reason of the suspension or termination of the employment contract prior to its expiration. Such an employee can also claim severance benefits from the estate of the insolvent employer, in accordance with section 41 of the Basic Conditions of Employment Act, 1997 (Act No. 75 of 1997).

With a liquidation, the creditors will be paid in the following order:

- Secured creditors (special mortgage, landlord’s legal hypothec, pledge or right of retention);
- Costs of the liquidation (which will include, inter alia, the sheriff’s charges incurred since the liquidation and fees payable to the Master in connection with the liquidation).
Financially distressed companies – What about the employees?... continued

- Costs of execution (which will include, inter alia, the taxed fees of the sheriff or messenger in connection with any execution upon any property of the company in liquidation and in connection with any proceedings which resulted in that execution);
- Former employees of the company for:
  - salary or wages due to the employee, for a period not exceeding 3 months (subject to the statutory limitation in place at that time); and
  - any severance or retrenchment pay due to the employee in terms of any law, agreement, contract, wage-regulating measure, or as a result of termination in terms of section 38 of the Insolvency Act;
- SARS, as well as other statutory obligations that the company has (as set out in section 99 of the Insolvency Act);
- Payment of claims that were secured by a general mortgage bond; and
- Unsecured creditors.

Conclusion

We hope that this newsletter has shed some light on the effect of business rescue and liquidation on employment contracts. Our Business Rescue, Restructuring and Insolvency team at Cliffe Dekker Hofmeyr can assist all role players in the business rescue and liquidation sectors on all issues, including the effect of business rescue and liquidation proceedings on employment contracts. Therefore, if you have any further questions, please contact us, in order for us to set up a consultation as soon as possible.

Aadil Patel
Director
Kgosi Nkaiseng
Director
Anli Bezuidenhout
Senior Associate
Stephan Venter
Associate
Jessica Osmond
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 Nkaiiseng
Director
Dispute Resolution
T +27 (0)11 562 1864
E kgosi.nkaiiseng@cdhlegal.com

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

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

Belinda Scribe
Director
Dispute Resolution
T +27 (0)21 405 6399
E belinda.scribe@cdhlegal.com

Andrew MacPherson
Senior Associate
Dispute Resolution
T +27 (0)11 481 6359
E andrew.macpherson@cdhlegal.com

Pauline Manaka
Senior Associate
Dispute Resolution
T +27 (0)21 481 6359
E pauline.manaka@cdhlegal.com

Vincent Manko
Senior Associate
Dispute Resolution
T +27 (0)21 405 6080
E vincent.manko@cdhlegal.com

Kylene Weyers
Senior Associate
Dispute Resolution
T +27 (0)21 405 6080
E kylene.weyers@cdhlegal.com

Ngeti Dlamini
Associate
Dispute Resolution
T +27 (0)11 562 1331
E ngeti.dlamini@cdhlegal.com

Courtney Jones
Associate
Dispute Resolution
T +27 (0)11 562 1331
E courtney.jones@cdhlegal.com

Johanna Lubuma
Associate
Dispute Resolution
T +27 (0)11 562 1331
E johanna.lubuma@cdhlegal.com

Stephan Venter
Associate
Dispute Resolution
T +27 (0)11 562 1331
E stephan.venter@cdhlegal.com

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JOHANNESBURG
1 Protea Place, Sandton, Johannesburg, 2196. Private Bag X40, Benmore, 2010, South Africa. Ds 154 Randburg and Ds 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. Ds 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

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