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BUSINESS RESCUE, RESTRUCTURING & INSOLVENCY

NEWSLETTER

DISPUTE RESOLUTION

IN THIS ISSUE

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The November rains breathe new life into nature and mark the completion of the transition from spring to summer. The change in seasons reminds us of the new life and potential that are ever-present, just sometimes hiding and waiting for the opportune moment to grow. The Christmas trees and decorations all over stores and shopping centers are another welcome sight as they serve as a reminder of the closeness of the December break.

The fast-approaching December madness also reminds us to pace ourselves and plan accordingly, to ensure that work is precise and not rushed. This is evident in the Tongaat-Hulett business rescue, where the practitioners have requested an extension of the deadline to publish the business rescue plan. Although not uncommon, these extensions always have an impact on the provision of intermediary financing and payment of suppliers.

Members of the public were caught off guard with the announcement that Tongaat-Hulett has been placed in business rescue. Like many of the high-profile rescues of recent times, all eyes will be fixed on the implementation of the business rescue plan as its success is vital to ensure farmer livelihoods, thousands of jobs, and that one of major players in the sugar sector survives a period of intense financial distress. The debt burden of Tongaat-Hulett remains, as large-scale suppliers still need to be paid. Despite seemingly timeously placing itself in business rescue, Tongaat-Hulett is not yet out of the woods, and will still be waiting for its breath of new life as it restructures its operations and affairs. In other business rescue news, eBundu Lodge, situated between Mbombela and White River, was placed under business rescue by the Mpumalanga High Court.

In some good news, SAA has finally submitted its financial statements for the past four years to the Auditor-General for review. After the last set of statements for 2017/18 raised eyebrows on SAA being labelled as a *"going concern"*, review of the group financials for 2018/19, 2019/20, 2020/21 and 2021/22 will finally provide the clarity many have been waiting for. This, along with its announcement of new air travel routes, and increasing the servicing of high-demand, under-supplied routes, indicate that SAA's recovery may be well underway. The proof, however, is in the pudding, and the pudding is only ready when the audited financial statements are open for public viewing.

In this month's newsletter, we consider the impact insolvency practitioners will face with the welcome declaration from the Financial Sector Conduct Authority that *"crypto assets"* will now be considered a financial product under the Financial Advisory and Intermediary Services Act 37 of 2002. Further, we discuss whether liquidators may dispose of property pending a business rescue application.

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The dawn of crypto regulation: Impact on insolvency practitioners

Crypto creditors and investors are now one step closer to enjoying the same protections that any other creditors and investors enjoy. This comes as a result of the widely welcomed declaration by the Financial Sector Conduct Authority (FSCA) that "*crypto assets*" will now be considered a financial product under the Financial Advisory and Intermediary Services Act 37 of 2002 (FAIS Act) (declaration).

Just a few weeks prior to the declaration, we wrote an article analysing the difficulties faced by liquidators of crypto companies, due to the unique nature of the crypto companies and crypto assets. While the focus of the article was on the liquidators themselves, many of the difficulties mentioned are also of concern for crypto creditors and investors, as they are the ones who feel the financial impact when things go wrong in the winding up of a company.

In this alert we focus on two important aspects of the liquidation process from a creditor and investor perspective, and look at how the declaration aims to provide some much needed protection when dealing with the winding up of financial services providers (FSPs) rendering financial services in relation to crypto assets (Crypto Asset FSPs). However, it should be noted that many of the additional protections are contained in the General Code of Conduct for Authorised Financial Services Providers and Representatives, 2003 (General Code) and Crypto Asset FSPs have until 1 December 2023 to ensure that they are compliant with the General Code.

SAFEGUARDING CRYPTO ASSETS

Prior to the declaration, one of the issues liquidators had to deal with, was determining whether the crypto assets held by a Crypto Asset FSP, were held in the company itself, or in trust. Assets that are held in trust are separate to a company's other assets and are not subject to distribution to creditors by a liquidator.

When it comes to crypto companies it is not always clear whether investors' assets are held in trust or not, and foreign courts have held that the point of departure is what is set out in the "*terms and conditions*" of the company. However, due to a lack of

The dawn of crypto regulation: Impact on insolvency practitioners

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regulation, crypto companies are free to change and update their terms and conditions regularly and without notice. Essentially, nothing prevents a crypto company from changing its terms and conditions when it is on the brink of insolvency.

The ambiguity as to the manner in which crypto assets and funds are to be held by Crypto Asset FSPs are now largely addressed by the requirements contained in the General Code. To the extent that a Crypto Asset FSP either holds client funds for the purpose of purchasing crypto assets, or holds crypto assets on behalf of a client, section 10 of the General Code requires that the Crypto Asset FSP, amongst other things:

- take reasonable steps to ensure that clients' financial products are readily discernible from private assets or funds of the provider;
- open and maintain a separate account, designated for client funds, at a bank; and
- ensure that the separate account only contains funds of clients and not those of the provider.

Additionally, according to the FSCA, holding or maintaining a crypto asset in safe custody or managing a crypto asset on behalf of a client will cause the crypto asset to qualify as *"trust property"* under the Financial Institutions (Protection of Funds) Act 28 of 2001 (FI Act). Section 4 of the FI Act provides further protection and clarity by requiring that trust property be kept separate from other company assets and declaring that trust property *"under no circumstances forms part of the assets or funds of the financial institution or nominee company"*.

The declaration has thus provided some much needed certainty as to the manner in which assets should be dealt with by a liquidator.

TRACING FUNDS

In our previous alert, we discussed the practical difficulties faced by liquidators in tracing the assets or funds that are the subject of an impeachable transaction. In many instances, funds which should be included in the pool available for distribution to creditors, are untraceable. Additionally,

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impeachable transactions prove impossible to reverse due to a lack of access to financial records and the relative anonymity surrounding many of the transactions.

Both the FAIS Act itself, as well as the General Code, contain monitoring, recording and control conditions which Crypto Asset FSPs will now be required to comply with. Section 3(2) of the General Code requires FSPs to have systems in place to store and retrieve records and any other material documentation relating to the client or the financial services rendered. Both sections 11 and 12 contain requirements relating to internal procedures that ensure the protection and accuracy of financial and other information.

Furthermore, in terms of section 19(3) of the FAIS Act, an FSP is required to keep records regarding the money and assets it holds on behalf of clients and to submit to the FSCA a report from the auditor that conducted the audit, confirming, amongst other things, the amount of money and financial products it held on behalf of clients at year end.

These requirements, while not unreservedly solving the traceability issues, go a long way in ensuring that proper records and information regarding past transactions are kept.

In our view, the declaration is a positive step in the direction of greater certainty and increased security in the crypto space. This means better protection for creditors and more certainty for liquidators faced with the task of winding down a Crypto Asset FSP. Although the declaration is less than a month old and the practical impact is yet to be seen, in theory, crypto creditors and investors can sleep easier at night.

LUCINDE RHOODIE AND
KARA MEIRING

May liquidators dispose of property pending a business rescue application?

Consider a scenario where the liquidators of a company (in liquidation) conclude an agreement for the sale of the company's immovable property in the midst of various (unsuccessful) business rescue applications, one of which is still pending at the time of the conclusion of the sale agreement.

The question that recently came before the Supreme Court of Appeal (SCA) in *Southern Sky Hotel and Leisure (Pty) Ltd and Others v Southern Sky Food Enterprises (Pty) Ltd* (617/2021) [2022] ZASCA 134 (13 October 2022)was whether, in such circumstances, the contract is invalid due to the application of section 131(6) of the Companies Act 61 of 2008 (Act).

Section 131(6) effectively states that the launching of a business rescue application suspends liquidation proceedings that have already commenced by or against a company until (i) the court has decided on the business rescue application; or (ii) if the business rescue application is successful, such proceedings have come to an end.

BACKGROUND FACTS

In 1967, the Phalaborwa Mining Company established the Hans Merensky golf course. The golf course and surrounding land were later purchased by the Hans Merensky Country Club (Pty) Ltd, which developed it into a golf estate. The first appellant, Southern Sky Hotel and Leisure (Pty) Ltd (the company), in turn bought the estate and developed it into the Hans Merensky Hotel and Spa. Between 2003 and 2007 investors bought immovable property from the club and developed it into furnished bush lodges. The investors then entered into rental pool agreements with the club in terms of which the club had the right to lease out the bush lodges to the public. The company later took over the management of the rental pool agreements and assumed liability thereunder.

May liquidators dispose of property pending a business rescue application?

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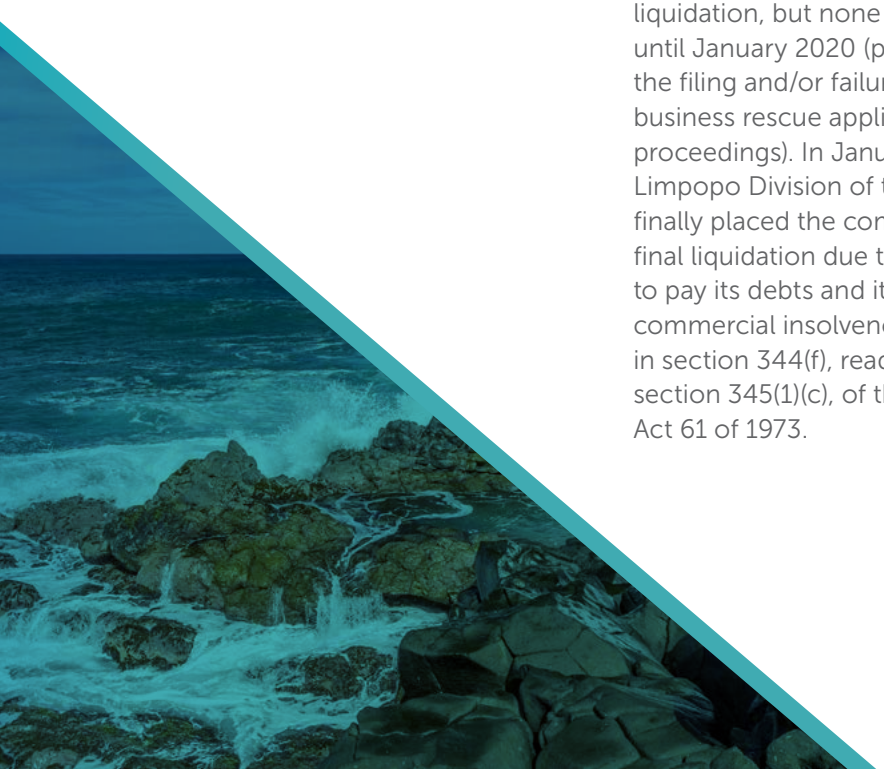

The first sign of trouble appeared when occupancy in the hotel dropped dramatically after the 2010 FIFA World Cup. By 2013, the company was in financial distress and unable to honour its obligations under the rental pool agreements.

LIQUIDATION

From 2013, multiple attempts were made by the investors and other creditors to place the company in liquidation, but none succeeded until January 2020 (partially due to the filing and/or failure of numerous business rescue applications and proceedings). In January 2022 the Limpopo Division of the High Court finally placed the company under final liquidation due to its inability to pay its debts and its factual and commercial insolvency as envisaged in section 344(f), read with section 345(1)(c), of the Companies Act 61 of 1973.

Liquidators were appointed in February 2020, and in September 2020 their powers were extended to allow them to, among other things, dispose of the company's movable and immovable property by public auction.

In November 2020, the liquidators resolved to put the company's immovable property on auction, which was advertised to take place on 23 and 24 February 2021. On 1 December 2020 one of the company's creditors launched another business rescue application, triggering the application of section 131(6) of the Act. This application was only enrolled for hearing on 11 March 2021, which was after the liquidator-driven auction was to take place. Southern Sky Food Enterprises (Pty) Ltd (Sky Food), applied for and was granted leave to intervene with this business rescue application.

Despite the pending business rescue application, the liquidators proceeded with the online auction for the sale of the company's immovable property and the sale of its business as a going concern on 23 and 24 February 2021. Sky Food was represented at the auction, was the highest bidder, and concluded a sale agreement with the liquidators.

Later, however, Sky Food raised a concern over the validity of the auction and the sale agreement. The concern centred around the fact that both the auction and sale agreement had been concluded after the launching of the last business rescue application, which effectively suspended the liquidation proceedings. It thus launched an urgent application out of the Gauteng Local Division of the High Court, Johannesburg (High Court). The High Court declared the agreement invalid and set it aside. The decision was taken on appeal to the SCA.

May liquidators dispose of property pending a business rescue application?

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BEFORE THE SCA

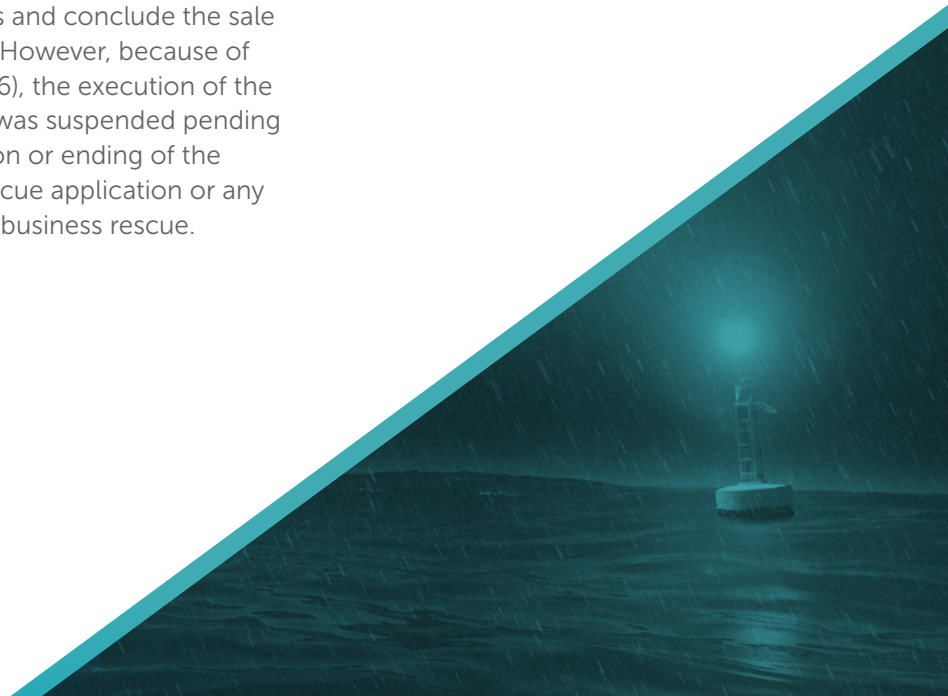
The question before the SCA was two-fold: first, whether there had been a valid business rescue application in terms of section 131(6) of the Act, and second, whether the agreement was invalid by virtue of section 131(6)'s provisions.

The court assumed, without deciding, that the business rescue application was properly made.

It held that although section 131(6) suspends the liquidation proceedings it does not suspend the legal consequences of a winding-up order. It is the latter which allows for the continuation of the realisation of the assets of the company in liquidation. The SCA therefore found that there was no indication in section 131(6)'s text, context or purpose which resulted in an intention to nullify agreements of sale concluded by the liquidator, pending business rescue proceedings. Section 131(6), said the court, does not suspend the appointment, office or powers of a liquidator; it only suspends the process of liquidation. Since the agreement in this case provided that the disposal would only take effect upon resolution of the business rescue application proceedings, there was no reason why the liquidators could not exercise their powers and conclude the sale agreement. However, because of section 131(6), the execution of the agreement was suspended pending the resolution or ending of the business rescue application or any subsequent business rescue.

The court thus concluded that the agreement had been valid, but its execution was suspended only until the suspension of the liquidation proceedings fell away.

BELINDA SCRIBA AND LISO ZENANI



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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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