Hogan Lovells sheds light on business rescue in construction industry

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In light of a struggling construction sector in South Africa and many companies going into liquidation or business rescue, and with the business rescue success rate only 10% on average for companies in South Africa, law firm Hogan Lovells says it is crucial for construction companies to carefully manage challenging conditions.

Hogan Lovells partner and business rescue and insolvency expert **Alex Eliott** tells *Engineering News* Online that a successful business rescue in South Africa typically takes between five and six months; however, according to chapter six of the Companies Act, it should take only three months.

In practice, however, it is not possible for a company of any size to resolve issues in such a short time.

"It can take much longer, depending on the nature of the company and what the plan entails. For example, with construction group Basil Read, which went into business rescue in June, the business plan approval meeting is only in September, and the company's plan states that it will complete projects during the business rescue period."

Additionally, from a business rescue point of view, construction companies have the issue of retentions. Eliott explains that there is often a 10% retention on a project, which is held back by the employer until the end of the defects period. If a company is placed in liquidation it will lose the retention, whereas if placed in rescue it may be able to complete the project and earn the retention. Construction companies also face the risk of clients cancelling contracts even if 90% of the work has been done, as soon as non-compliance with the contract occurs.

Hogan Lovells partner and construction practice head **Clive Rumsey** says it is, therefore, crucial for companies to ensure contractors in business rescue are complying with the underlying terms in the contract with the client.

“Being in business rescue does not excuse a company from contractual obligations,” adds Eliott, which puts more pressure on the business rescue practitioners to keep the clients happy.

Eliott says the biggest factor leading companies into business rescue is poor management, regardless of industry-wide issues.

Rumsey comments that it is not only the management of the company, but also the management of projects that makes a difference.

“Construction companies have to manage cash flow on projects to ensure they get payment as soon as possible."

“The average contractor waits for more than 30 days to be paid. If the contractor has equipment on site and labour to pay at the end of the month, and the work still needs to be certified, only then are the companies entitled to payment. If the contractor is not managing the process of certification and payment properly, it could take as much as 90 days for payment to be made, while labour and equipment costs have already been covered,” he adds.

Rumsey notes that the claims process in construction contracts should also be efficiently managed to ensure that matters are

resolved either by negotiation or by implementing the dispute resolution process.
With regard to the 10% business rescue success rate, Eliott points out that it does not mean business rescue pre-empts failure, because the alternative would have been liquidation. "You have guaranteed failure if a company is liquidated, while business rescue ensures [some] chance of success."
Eliott says it is possible for companies to achieve a better performance after business rescue and make a turnaround. However, he adds that it is often difficult for management to turn the business around themselves and that it is more likely to happen when management changes or when an outsider comes in.
Rumsey notes that business rescue may have advantages, such as the opportunity to terminate bad contracts, or sell non-performing assets or divisions because companies may have good management and service delivery, but bad contracts or divisions which could cause a downfall in the business.
"Business rescue poses opportunities for restructuring assets, equipment, procurement, management and contracts."
Eliott avers that there could be an upside to certain parties either way; when companies enter business rescue and make it out the other side, it is positive for them, but should the company get liquidated, albeit unfortunate, it poses more work opportunities for other players in the market and also narrows competition in the market.
Eliott, meanwhile, stresses the importance of choosing an ethical and professionally accredited business rescue practitioner to allow the business rescue process to succeed.

“The practitioner should [be] objective [and] know when to cut off which projects and not cling to professional pride that some employees may have to finish projects that are badly impacting on the company,” explains Eliott.

Meanwhile, Rumsey foresees an improvement in conditions in the construction sector, which should impact on the rate of business rescue and liquidations. Once major infrastructure projects start going out to tender from government, such as the proposed Gautrain expansion, Durban Port expansions, gas-to-power projects and road projects and mining sector expansions, the improvements should come about.

Many projects that have been put on hold for some time are now coming on stream.

Additionally, Rumsey expects many housing construction projects to be forthcoming, what with the major housing shortage, which government needs to address. He says this will bode well for smaller construction companies, since many small, medium-sized and microenterprise contractors are drawn into housing projects.

Rumsey advises that, in tough times, construction companies are best advised to operate in a lean fashion by keeping their overheads to a minimum and perhaps selling off noncore assets and businesses, while retaining managers and executives who are proficient and experienced in the construction industry