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DISPUTE RESOLUTION ALERT

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SECTION 34 OF THE INSOLVENCY ACT: A TICKING TIME BOMB?

In many, if not all, commercial transactions, timing is everything, either for a distressed seller or a purchaser stumbling upon a deal that may almost be too good to be true. There is often no time to waste and a deal must be closed as soon as possible. In the haste of closing a deal, whether in the form of a sale of business or a sale of assets, the parties often agree not to comply with the provisions of s34(1) of the Insolvency Act, No 24 of 1936 (Act), each willing to take the risk in not doing so.

VEXATIOUS LITIGANTS

A vexatious litigant is a person who persistently initiates legal action for the purposes of harassing or subduing an adversary. Unfortunately, the victims of these vexatious litigants cannot simply ignore the frivolous legal proceedings instituted and are forced to respond in accordance with the rules of court regardless of how ridiculous the claims may be.

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SECTION 34 OF THE INSOLVENCY ACT: A TICKING TIME BOMB?

If all goes according to plan, the six month period will pass and the purchaser and seller will each go their merry way.

In this alert, we illustrate, with reference to a hypothetical scenario, the practical consequences a purchaser could find itself in, in such circumstances where there has been no compliance with s34.

In many, if not all, commercial transactions, timing is everything, either for a distressed seller or a purchaser stumbling upon a deal that may almost be too good to be true. There is often no time to waste and a deal must be closed as soon as possible. In the haste of closing a deal, whether in the form of a sale of business or a sale of assets, the parties often agree not to comply with the provisions of s34(1) of the Insolvency Act, No 24 of 1936 (Act), each willing to take the risk in not doing so.

Section 34(1) of the Act provides that:

> "If a trader transfers in terms of a contract any business belonging to him, or the goodwill of such business, or any goods or property forming part thereof (except in the ordinary course of that business or for securing the payment of a debt), and such trader has not published a notice of such intended transfer in the Gazette, and in two issues of an Afrikaans and two issues of an English newspaper circulating in the district in which that business is carried on, within a period not less than thirty days and not more than sixty days before the date of such transfer, the said transfer shall be void as against his creditors for a period of six months after such transfer, and shall be void against the trustee of his estate, if his estate is sequestrated at any time within the said period." (own emphasis)

As some form of comfort the purchaser would insist on and the seller would agree to indemnify the purchaser against any and all claims or loss which the purchaser may suffer as a result of the parties not complying with the provisions of s34.

If all goes according to plan, the six month period will pass and the purchaser and seller will each go their merry way. Unfortunately, more often than not, the seller is liquidated within the six month period referred to in s34, after the purchaser paid the purchase consideration and taken possession of the business or assets purchased, and the purchaser is left in the most precarious position, had the parties not placed the required advertisement as required in terms of s34.

Below we illustrate, with reference to a hypothetical scenario, the practical consequences a purchaser could find itself in, in such circumstances where there has been no compliance with s34.

A purchaser and a seller enter into an agreement in terms of which the seller sells its manufacturing business to the purchaser as a going concern for R10 million. The purchaser and the seller agree to not advertise the sale in accordance with the provisions of s34. The seller provides the purchaser with an indemnity against all claims and loss which the purchaser may suffer as result of the failure to advertise. The purchaser pays the seller the R10 million purchase consideration and takes ownership of

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CONTINUED

Where the transaction was not one for the sale of business but for specific assets sold by a trader, it is not enough for a purchaser to raise the fact that the assets so purchased are no longer in its possession as a defence.

the business, which the purchaser starts to operate for its own benefit. However, four months after the effective date of the transaction, the seller is liquidated.

What happens now? In terms of s34, a failure to advertise renders the transfer of the business not the underlying sale agreement, from the seller to the purchaser void as against the liquidator and the creditors of the seller. In practical terms that means that although the purchaser complied with its obligations in terms of the sale agreement and made payment of the purchase consideration to the seller, transfer of ownership and benefit in the business and assets comprising the business is void vis-à-vis the liquidator and creditors – in other words ownership in the business and assets remain vested in the liquidator with effect from the date of the liquidation, notwithstanding payment by the purchaser of the purchase consideration to the seller.

The liquidator can in such instances demand that the purchaser returns the business and all assets sold a part of the business to the liquidator, and should the purchaser fail to do so, the liquidator can approach the court for an order that the business and assets are so returned. The purchaser would in effect, since the date of liquidation, have been operating the business on behalf of the liquidator and it must be kept in mind that more often than not, one of the assets sold as part and parcel of the business is the lease to the premises. The purchaser would in such circumstances have to surrender occupation of the premises from which the business is operated.

Where the transaction was not one for the sale of business but for specific assets sold by a trader, it is not enough for a purchaser to raise the fact that the assets so purchased are no longer in its possession as a defence. The court in *Gore and Another v Saficon Industrial (Pty) Ltd 1994* (4) SA 536 (W) held:

> "...in general, a purchaser under an agreement of sale which is void by reason of the provisions of s34(1) of the Act, who is unable to deliver the sale assets to the trustee or liquidator, as is the case in casu, is obliged to pay the trustee or liquidator the value of such assets. The case of *Adams' Trustee v Paizes and Another* (supra at 197), to which I have previously referred, is support for this proposition. Furthermore, the leading texts on the law of insolvency in our law also reflect the view that a purchaser under a void sale is obliged to pay the value of assets where for any reason delivery is not possible."

The risks are not limited to a scenario where a seller is liquidated within the six month period. In the absence of any advertisement, during the six-month period an individual creditor of a seller can institute proceedings against the seller and obtain judgment which can then be executed against the business, goods or property transferred by the seller to the purchaser, notwithstanding that such is or are in the possession of the purchaser. During the relevant period, it is open to a creditor who has not obtained judgment against the seller, also to seek a declaration from the court against the purchaser to the effect that the transfer is void as against creditors and this declaration will enable execution to be levied on the property in the hands of the purchaser at any time.

What is the purchaser left with in these scenarios? Unfortunately, not much. The purchaser, if the seller is liquidated, after

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Any indemnification provided by the seller will have no value, as the seller is in liquidation. The purchaser thus stands to lose a substantial amount of money.

return of the business and/or assets will be left with only a concurrent claim against the insolvent estate. In the above scenario this would mean that the purchaser would be out of pocket by R10 million, paid to the seller, and having to hand back the business to the liquidator. A liquidator would in all probability sell the same business, already purchased by the purchaser, to another third party and the proceeds, after provision for the costs of liquidation, will fall in the free residue pot to be shared by all concurrent creditors of which the purchaser would be one.

Any indemnification provided by the seller will have no value, as the seller is in liquidation. The purchaser thus stands to lose a substantial amount of money.

The prejudice in the second scenario ie where the seller is not liquidated, would be less and limited to the value of the creditors' claims executed against the assets purchased by the purchaser, and the purchaser would on paper have a solvent entity to enforce any indemnity claim against.

The lesson to be learned is to make as sure as possible that the risk of the seller being liquidated within the ensuing six month period is almost non-existent should the parties agree than s34 advertisements would not be placed. To limit the risks further, additional indemnifications from parties other than the seller must be obtained.

It is clear that "high risk high reward" may not always be the way to go when s34 is applicable even if the deal to be struck is too good to be true.

Lucinde Rhoodie and Ngeti Dlamini

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VEXATIOUS LITIGANTS

The Vexatious Proceedings Act, No 3 of 1956 (the Act) seeks to provide relief to applicants that can demonstrate that a respondent has persistently instituted legal proceedings without reasonable grounds.

A vexatious litigant is a person who persistently initiates legal action for the purposes of harassing or subduing an adversary. Unfortunately, the victims of these vexatious litigants cannot simply ignore the frivolous legal proceedings instituted and are forced to respond in accordance with the rules of court regardless of how ridiculous the claims may be.

In the matter of Christensen NO v Richter 2017 JDR 1637 (GP), an application in terms of s2(1)(b) of the Act was brought to declare the first respondent, a vexatious litigant.

The Vexatious Proceedings Act, No 3 of 1956 (the Act) seeks to provide relief to applicants that can demonstrate that a respondent has persistently instituted legal proceedings without reasonable grounds. Furthermore, the Act seeks to protect an applicant who is subjected to costs and unmeritorious litigation as well as the functioning of the courts to proceed unimpeded by groundless proceedings.

The applicant can make an application to court for an order declaring the respondent a vexatious litigant. The effect of this is that the respondent can no longer institute legal action in any court against the applicant without leave of the court. The court will only grant such leave if it is satisfied that the legal action is not an abuse of the court process and that there are *prima facie* grounds for the proceedings.

In the matter of *Christensen NO v Richter 2017 JDR 1637 (GP)*, an application in terms of s2(1)(b) of the Act was brought to declare the first respondent, a vexatious litigant. The first respondent had launched several applications against the estate. In deciding whether to declare the first respondent a vexatious litigant the court held that:

> "[the first respondent] is, in my view, a vexatious litigant. He should therefore be prevented from instituting any further legal proceedings against the estate and/ or its executors. I am satisfied under the circumstances that the applicants have made out a case for a final interdict. They have established a clear right for the granting of a final interdict. It is

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VEXATIOUS LITIGANTS

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In Beinash and Another v Ernst and Young and Others 1999 (2) SA 116 (CC), the court considered the constitutionality of s2(1)(b) of the Act.

clear that the applications launched by the first respondent are vague and not substantiated and the balance of convenience favours the granting of the final interdict. The first respondent cannot continue to litigate as relentlessly as he does, disregarding court orders. This has to stop. I am inclined to accept that the applicants have no alternative remedy to stop him from continuing with his actions."

In *Beinash and Another v Ernst and Young and Others 1999* (2) SA 116 (CC), the court considered the constitutionality of s2(1)(b) of the Act. The court confirmed that:

"the provision does limit a person's right of access to court. However, such limitation is reasonable and justifiable. While the right of access to court is important, other equally important purposes justify the limitation created by the Act. These purposes include the effective functioning of the courts, the administration of justice, and the interests of innocent parties subjected to vexatious litigation. Such purposes are served by ensuring that the courts are neither swamped by matters without any merit, nor abused in order to victimise other members of society".

Notwithstanding the fact that the right of access to courts is protected under s34 of the Constitution of the Republic of South Africa Act, No 108 of 1996 (the Constitution), this right can be limited in terms of s36 of the Constitution and justified to protect and secure the right of access for those with meritorious disputes.

Burton Meyer, Denise Durand and Thabo Mkhize

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BBBEE STATUS: LEVEL TWO CONTRIBUTOR
Cliffe Dekker Hofmeyr is very pleased to have achieved a Level 2 BBBEE verification under the new BBBEE Codes of Good Practice. 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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