BUYING A BUSINESS? MAKE SURE THE SELLER PUBLISHES NOTICE OF THE SALE

“The purpose of the legislature in enacting s 34(1) is to protect creditors by preventing traders who are in financial difficulty from disposing of their business assets to third parties who are not liable for the debts of the business, without due advertisement to all the creditors of the business.” (Extract from judgement below)

With our economy in trouble and the ongoing pandemic and lockdown damaging more and more businesses by the day, sales by distressed companies and traders are likely to rocket.

If you are a prospective buyer here, be aware of one particular danger lurking in the wings for you.

Follow this rule to protect yourself - before you buy any business, its goodwill or assets forming part of the business, take legal advice as to whether or not the sale must first be advertised in terms of section 34 the Insolvency Act. You stand to lose both the business and the purchase price if section 34 requires the sale to be advertised and it isn’t.

Your risk is that if an unadvertised sale is challenged by a liquidator/trustee (or by a creditor if there is no liquidation/sequestration) within 6 months of the sale, it is likely to be declared void. In that event, you will be lucky to get even a portion of your purchase price back - with the seller in financial difficulty your concurrent claim is probably worthless.

As a creditor…

The advertising requirement is designed to protect you as a creditor from having to claim from a debtor which suddenly becomes a worthless shell having quietly sold away its business and/or assets beyond your reach.

Note that you only have protection if you have instituted proceedings against your debtor “for the purpose of enforcing [your] claim” before the transfer of the business – a good reason not to drag your heels when suing a recalcitrant debtor.

When advertisement isn’t necessary

The sale will only be valid without advertisement if:

* The sale was made “in the ordinary course of business” (unlikely where the business subsequently fails), or
* It was made for “securing the payment of a debt” (unlikely to be under your control as buyer), or
* The seller wasn’t a “trader”. As “trader” is widely defined in the Act, and as the onus of proof here is squarely on the buyer, that’s not going to be easily proved. As we shall see below, you can be a “trader” in property as much as in any other commodity.

As a general rule therefore, it is safest to insist on the sale being properly advertised before you pay out the purchase price, but there are grey areas and pitfalls here so take specific advice. Note also that the Act’s requirements for the timing and manner of advertisement are strict and must be followed to the letter.

As a recent High Court case shows, as a buyer (in this case of a property business) you could lose everything if you lose sight of this very real danger…

An R8m claim and a property transfer (and bond) set aside:

* A property owner bought and developed a property firstly into a shopping centre and later into a shopping centre with 11 sectional title units.
* Whilst being sued by a creditor for R8m, the owner sold a section to a buyer and transferred it to him, and a bank registered a bond over the property.
* The creditor obtained judgement against the owner only to find that it had been placed into liquidation. It asked the High Court to set aside the sale on the basis that the sale had not been advertised in terms of section 34 and was therefore void.
* The buyer countered by denying that it was a “trader” as defined in the Insolvency Act. Its core business, it said, was to acquire and then rent out properties, “its business objective was not the buying and selling property per se as its stock in trade”.
* Finding on the facts that the owner was indeed a “trader” when it sold the property to the buyer, the Court set aside the sale, the transfer to the buyer, and the bank’s mortgage bond.