

TRADING IN PROPERTY? THE SALE MUST BE ADVERTISED

Hyde Construction CC v K2013046547 (South Africa) (Pty) Ltd and Others (9179/2019) [2020] ZAWCHC 31 (29 April 2020)

Our law requires that where a trader sells any part of his business other than in the normal course of business or to secure a debt, it is obligatory that he publishes notice of his intention to do so, for the protection of business creditors. Serious consequences can flow from the failure to do so, such as the voidability of a subsequent sale and transfer, and bond registration. Let your conveyancer assist when you are selling property that is stock in trade, as this is understood in insolvency law.

The Judgment can be viewed [here](#).

FACTS

In this application Hyde Construction CC (“Hyde Construction”) sought (i) to: set aside an agreement of sale entered into between Blue Cloud (as seller) and K2013046547 (Pty) Ltd (“K Company”) (as purchaser) in terms of section 34(3) of the Insolvency Act, 24 of 1936; and (ii) to set aside and declare void the subsequent transfer of the property to the K Company and registration of a bond in favour of the bank.

Blue Cloud purchased a property in Plettenberg Bay in 2003 and developed it into a shopping centre. Subsequently sectional title units were also erected. In July 2005, Blue Cloud contracted Hyde Construction to undertake alterations to the buildings. This work was done in the period between July 2005 to May 2007.

A dispute arose on the building contract and protracted litigation ensued. Action was initially instituted by Hyde Construction in April 2010 and due to various delays (separation of trials on the merits and quantum, together with appeals), judgment in favour of Hyde Construction was only delivered in May 2019.

However, after Hyde Construction had instituted the claim against Blue Cloud, Blue Cloud sold the property to the K Company. (The directors and main shareholders of Blue Cloud were, *inter alia*, Mr Lurie and Mr Borthwick. Lurie was also a director of the K Company.) Transfer of the property to the new owner was effected in August 2014.

In February 2019, Hyde Construction filed its practice note in respect of the *quantum* hearing which was set down for hearing on 25 February 2019. Five days later, an application for the winding up of Blue Cloud was filed by three entities (the directors and shareholders of which included Borthwick, his father and mother). When the quantum hearing took place a few days later, there was no appearance on behalf of Blue Cloud. After consideration of the papers filed, the Court held that it was clear that Blue Cloud had no intention of participating in the hearing and the trial continued in its absence. Judgment was granted in favour of Hyde Construction and Blue Cloud was ordered to pay it some R8 million.

According to Hyde Construction, the property was sold without notice thereof, contrary to the provisions of section 34(1) of the Insolvency Act which requires a “trader” to advertise when business goods are sold not in the ordinary course of business. (Section 34 (1) reads:

“(1) 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 ..., and such trader has not published a notice of such intended transfer in the Gazette, and in ... newspaper ... 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.

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(2) As soon as any such notice is published, every liquidated liability of the said trader in connection with the said business, which would become due at some future date, shall fall due forthwith, if the creditor concerned demands payment of such liability: Provided that ...

(3) If any person who has any claim against the said trader in connection with the said business, has before such transfer, for the purpose of enforcing his claim, instituted proceedings against the said trader –

(a) in any court of law, and the person to whom the said business was transferred knew at the time of the transfer that those proceedings had been instituted;

or

(b) in a Division of the Supreme Court having jurisdiction in the district in which the said business is carried on or in the magistrate's court of that district,

the transfer shall be void as against him for the purpose of such enforcement.”)

According to Hyde Construction, the effect of the sale was that:

- Lurie and Borthwick sold the property back to Lurie and others, in the form of the K Company, as Lurie was also a co-director of the K Company;
- the business model of Blue Cloud was to purchase properties, develop same and then trading with such properties by selling them off, and not holding onto them for investment purposes. It was therefore a “trader” as defined and required to advertise the sale of the properties to K Company.

Blue Cloud described their business by stating that it was the intention of the shareholders to only purchase properties and to develop same and then to hold these for investment purposes, in particular, by establishing a rental enterprise at each property. It denied that its business objective was to buy and sell property as its stock in trade. They submitted that the properties that they indeed sold, were incidental processes to their core business. They alleged that properties would be sold only if Blue Cloud’s investment objectives were not met by the holding of such properties. Four scenarios under which the properties were disposed of were given; when the rental income which was either not profitable enough for investment purposes or did not meet the “loan to value” requirements of the mortgagee; or was not enough to pay the expenses incurred in respect of the property; or Blue Cloud would otherwise sell such properties if approached by interested purchasers such as the tenants of the property and Blue Cloud stood to make a substantial profit from the sale of such asset(s). Blue Cloud maintained that such sales were ancillary to the main business of Blue Cloud which was investing in commercial immovable property and generating rental income from such properties.

HELD

- The purpose of section 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.
- The provisions of section 34(1) only apply if the company is a ‘trader’, which in turn is defined in section 2 of the Insolvency Act. In section 2 of the Insolvency Act, a trader is defined to mean “... any person who carries on any trade, business, industry or undertaking in which property is sold, or is bought, exchanged or manufactured for purpose of sale or exchange, or in which building operations of whatever nature are performed, or ... ; and any person shall be deemed to be a trader for the purpose of this Act ... unless it is proved that he is not a trader as hereinbefore defined : Provided that if any person carries on the trade, business, industry or undertaking of selling property which he produced (either personally or through any servant) by means of farming operations, the provisions of this Act relating to traders only shall not apply to him in connection with his said trade, business, industry or undertaking”.
- In order for Hyde Construction to be successful in setting aside the sale of the property in terms of section 34(3) of the Insolvency Act, it had to prove that Blue Cloud was a “trader”, as defined in section 2 of the

Insolvency Act, when it sold the property to the K Company.

Did Blue Cloud carry on a trade falling into one of the categories specified in section 2?

- The approach to be adopted is to ascertain whether Blue Cloud was a trader by having regard to the nature of its undertaking and determining whether such an undertaking was part of its core business, or incidental thereto.
- What was common cause between Hyde Construction on the one hand and Blue Cloud and the K company on the other, is that Blue Cloud purchased properties, developed such properties and eventually sold such properties. The only issue in dispute was that Blue Cloud and the K company alleged that such sales would only be made under specific circumstances and not as a matter of course as its core business.
- In the present matter Blue Cloud admitted that they purchased properties, developed such properties and then tenanted the properties whereafter they would sell those properties as “rental enterprises”.
- However objectively it seemed as though Blue Cloud did hold onto properties until circumstances were favourable to sell, with a degree of continuity and regularity, and constituted trading in properties.
- These activities occurred at the relevant time, i.e. Blue Cloud was acting as trader at the time of the sale to the K company.

What are the consequence of an unlawful disposition?

- Section 34 indicates that such transfer is void. That is not the end of the enquiry. The question remains if it is void only to the extent of the creditor’s claim. (In this instance, the R8 million owing to Hyde Construction) or whether it is void *in toto*.
- The relevant portions of section 34 show that: (i) there is a direct relationship between the creditor’s claim and the proceedings for enforcing it; the transfer is void for the purpose of the enforcement. There is, therefore, a clear correlation between the enforcement of the claim and the extent to which the transfer is void and our courts have held that a transfer shall be void only as against the creditor for the purpose of such enforcement, and to the extent to which the creditor had previously successfully instituted proceedings.
- In the present matter, the seller of the property was also (part) purchaser of the property and it appeared as if the sale was a contrived affair.
- In fact, in this matter the auditors of Blue Cloud provided a letter stating that in their opinion, the company was not a trader at the time and that section 34 of the Insolvency Act did not apply to the proposed sale of the land and buildings. Blue Cloud used the proceeds of the sale to settle its legal fees, rates and settled the bond. It was apparent that the bank was not an innocent bystander in that they were a party to the sale agreement between Blue Cloud and the K Company; and despite the settling of Blue Cloud’s bond, that same bank was again called upon to mortgage the very same property in favour of the K Company. (The bank had in fact negotiated 25% profit participation in the disposal of one of Blue Cloud’s units.)
- The entire sale and purchase was thus contrived and evidenced a systematic endeavor to retain the property and escape the payment of the judgment debt that it owed to Hyde Construction.

CONCLUSION

The application therefore succeeded and the transfer and registration of bond were declared void.