

SMALL AND MEDIUM SIZED ENTERPRISES

INSOLVENCY & BUSINESS RESCUE

SME cashflow threats: when liquidation strikes a supplier or customer

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An SME that permits its customers and suppliers to trade with it on credit terms, does so in the hope that deferred payment will result in more business. There is a dark side lurking to this arrangement, which goes beyond a mere payment delay or default. When a customer or supplier with a large amount owed on account to the SME suddenly falls into liquidation, various risks immediately arise, and it is useful to outline a few issues that are common to most liquidation processes.

A liquidation generally results in the cessation of business and trading operations. The Master's Office appoints a liquidator, who takes control of the company's assets and property. This will include any cash and investments, the securing of any immovable property, and the taking into possession of trading stock and movable property like equipment and furniture, as well as the debtors' book. A liquidator is responsible to secure all assets (for the benefit of creditors, at a later stage), and must take the necessary steps to recover any assets (such as property or payment) from third parties.

A liquidator must also take steps to identify and assess the creditors of the liquidated company. Often, the liquidated company's books and records are incomplete and unreliable, so it is not uncommon for a liquidator to have no knowledge of some of the creditors (in which case they will receive no formal notifications and correspondence pertaining to the liquidation process). An SME creditor must be aware of developments in the process, be recorded as a creditor, and liaise with the liquidator through the appropriate channels.

Creditors' meetings are convened, and at those meetings claims can be lodged, resolutions determining the liquidator's authority and powers can be considered and voted on, and further directions can be given by the creditors.

A liquidator might also convene a formal insolvency enquiry, where the directors of the liquidated company are usually required to testify as to the business, assets and affairs of the company, and the reasons for its demise. An enquiry can also involve other third parties being called to testify as to the amounts they owe to the liquidated company, or the payments that they received prior to its liquidation. It is common, following an insolvency enquiry, for the liquidator to institute legal proceedings against the liquidated company's directors (for damages for reckless or negligent trading), or against third parties for recovery of assets, even if those third parties received payment in what appeared to be legitimate and standard commercial practice.

Directors of an SME creditor may be called to provide information / documentation or testify (under oath, and usually through questioning by an attorney or advocate) at an insolvency enquiry, and may receive a demand or subpoena to do so – this is a red flag for such directors, and if legal representation has not already been engaged, this would certainly be the time to do so, in order to avoid or limit subsequent liability or loss.

The SME creditor's formal claim to participate in any liquidation dividend, needs to be prepared in accordance with statutory requirements, correctly and timeously lodged at the appropriate Master's Office, and advanced / proved at a meeting of creditors. Only proved creditors can vote at meetings, and only proved creditors can share in any liquidation dividends in the future. It is not thus uncommon for other creditors to oppose attempts to prove claims: this will largely be a legal argument, premised on the prevailing facts and the legal treatment of different types of claims. Whether or not a claim should be proved will include an assessment of whether or not the SME creditor is likely to participate in a liquidation dividend – if not, a proved SME creditor is at danger of suffering the dual blow of not being paid a portion of its debt, and being responsible to contribute to the costs of administering the liquidated company.

Whether any liquidation dividend will ever be paid to a proved SME creditor depends on a number of factors, including the value of the assets that have been recovered and which are available for distribution, the extent of security held by creditors (such as a mortgage bond, notarial bond, reservation of ownership, etc), the amounts owed to SARS and employees, and the costs of the liquidation process. Concurrent creditors (those not secured and those given preference in terms of statute) are only paid if there are assets available after payment to secured and preferent creditors. This can be a months-long or even years-long process.

If an SME's customer or supplier goes into liquidation, it is immediately time for the SME to engage legal representation. The liquidation process is complicated and confusing, is fraught with procedure and technicalities, and is often regarded as commercially unfair. It is a process that can be intrusive, and time-consuming, and a misstep can not only result in not receiving a liquidation dividend, but also being subject to legal proceedings to recover payment which the SME creditor believed it fairly and rightfully received. Strategic, commercial and financial decisions need to be made from the outset, and advanced knowledge of the principles, technicalities, and consequences of the process, is crucial.

An SME creditor that attempts to navigate this process without adequate knowledge and assistance, can inadvertently suffer crippling and costly unintended consequences. As is often the case, not incurring the costs of legal assistance, can quickly become far more costly.



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