PG INDUSTRIES (ZIMBABWE) LIMITED
versus
JONES HOLDINGS (PRIVATE) LIMITED

HIGH COURT OF ZIMBABWE
TSANGA J
HARARE, 10 March & 1 April 2015

Opposed Application

T Mpofu, for the applicant
O Ochieng, for the respondent

TSANGA J: On 18 December 2013, the applicant, PG Industries (Zimbabwe) Limited, sought and was granted an order in terms of s 191 of the Companies Act [*Chapter 24:03*] that scheme meetings be convened with members, secured lenders, secured supplier and debenture holders and concurrent creditors. This was for the purpose of considering the scheme of arrangement as part of an overall composite Scheme proposed by the applicant to essentially regain economic viability.

On 26 March 2014 following the holding of the various meetings, the applicant re-approached the court *ex parte*, seeking this time the court's sanctioning of the combined scheme. However, it was not to be as one of its creditors, Jones Holding the respondent herein, appeared in court and objected to the confirmation of the scheme. This was on the basis that it should have been regarded as a secured creditor. It made an oral application for leave to file its opposing papers. On 21 May 2014 Ndewere J granted Jones holdings leave to file its opposing papers on the basis that the court does not act as a mere rubber stamp to scheme arrangements. She also stated that the court has a duty to hear any objections in order to arrive at a proper conclusion regarding any provisions to be made for any party dissenting from the compromise arrangement. She placed reliance on s 193 (1) 9 (e) for this position and also drew strength from the local case of *Ex parte Macey's Stores Ltd* 1983 (2) SA 657 where objections where considered albeit ultimately the objections did not prevent the confirmation of a scheme.

Jones Holdings having filed its papers, this was the hearing of the opposed matter to the application for confirmation. The applicant's standpoint is that the scheme should be sanctioned by the court on the basis that it has been approved by the by the requisite majority among its various classes of shareholders and creditors as required by the law.

Section 191(2) on which it relies is couched as follows:

> *"**If the majority in number representing three fourths in value of the creditors or class of creditors or members or class of members,*** as the case may be present and voting either in person or by duly authorised agent or proxy at the meeting, agree to any compromise or arrangement, the compromise or arrangement shall, ***if sanctioned by the court,*** be binding on all the creditors."

Mr *Mpofu* on behalf of the applicant emphasised what he termed as the crucial factual and legal reality of the applicant having observed all the requisite legal steps needed for a scheme to be approved by the court. He also stated that the court cannot refuse to sanction the scheme on account of the objection of a single creditor. Such interference, he opined, would interfere with the whole body of creditors. He relied on the case of *Parker* v *WBG Kinsey & Co (Pvt) Ltd* 1987 (1) ZLR 188 SC where in the court stated that in an application to set aside a scheme, it would want to know the attitude of the creditors generally and would not be prepared to make a decision until the body of creditors had in some competent manner elected whether or not to annul the compromise or arrangement. Furthermore, he pointed out that to annul the scheme on account of one creditor owed roughly $600 000 when the sum total of those owed 21 million have approved the scheme would be manifestly unreasonable. His additional argument was that the applicant's claim will not change the numbers in terms of voting for the scheme. The applicant's position is therefore that the special treatment that the respondent seeks is not provided for in the applicable sections.

The respondent's major objection to the scheme is that the chairman of the scheme meetings erred in arriving at the conclusion that it is not a secured creditor. It bases its claim of being a secured creditor on the following facts. On 2 August 2011 it concluded a written agreement with PG merchandising limited (PGM) a subsidiary of the applicant whereby it sold its 30 % interest in Zimtile to the PGM and the applicant stood as guarantor. The price was US$1 500 000.00 payable as deposit of $750 000 and the balance in 12 equal monthly instalments of US$ 62 500 .00 with effect from 31st January 2012. The deposit was paid but it is the respondent's position that since its payment PG has only made sporadic payments as regards the balance. In terms of transfer the agreement of sale ownership of the sale shares as well as the risk and profit in the sale shares and Jones loan account passed to PG

Merchandising on the effective date. Share transfer, and a certified resolution of the directors of Jones Holdings recording their approval of the transfer, was to be made on payment in full of the purchase price. The effective date of the sale was July 1 2011. Interest was payable at the rate of 13% per annum. Penalty interest on any outstanding balance was also payable at the rate of 20% in addition to the normal interest. It was to be calculated on from the date on which the unpaid amount was due.

The respondent thus asserts that it is impossible for Zimtile to enter into the restructuring scheme without its approval. It insists that to date it has not resolved to approve the restructuring. It is argued that the chairperson of the Scheme meetings behaved contrary to the rules of natural justice in the manner he handled its claims. Its argument is also that since the title of the shares was to be only transferred upon full payment, it has a lien over the sale of the shares pending payment of the purchase price in full. Its position is that it would be manifestly unfair to disregard its interests when it took steps to protect its position as creditor.

On the basis of the above, the respondent's standpoint is that it is owed $1 164 422.30 as at April 30 2014. The respondent insists that it is not a concurrent creditor noting that the other creditors consist largely of trade creditors and utility organisations. The major difference is that it has a right of retention over 30% of the shares in Zimtile until it has been paid in full and is therefore secured by a debtor credit lien.

Mr *Ochieng* who argued on its behalf insisted that the court's concern should also be whether the scheme is a fair one and reasonable one. He pointed out that the secured creditors are owed $4 million whereas the respondent is owed $1 million - a reality he says which would have had a domino effect on other creditors. In favour of the non-sanctioning of the scheme, he argued that the secured creditors have been made to believe that the debt is a lot less than it actually is.

What the respondent demands as articulated in its papers that the applicant either seeks or obtains its consent, or that the scheme be not sanctioned. It says that if necessary, further meetings will need to be convened with the creditors. In the final analysis the respondent asserts that the application be dismissed with costs or alternatively that the court gives directions as to how the matter may be fairly resolved to the respondent's aforementioned scale.

The actual clause in the agreement of sale of the shares in question of the agreement regarding transfer of title that respondent says makes it a preferential creditor through retention of possession reads as follows:

9.1 Within seven days of payment in full of the purchase price and of all interest and other amounts due in terms of this agreement Jones Holdings shall deliver to PG Merchandising the following documentation:

9.1.1 Share transfer forms duly signed on behalf of Jones Holdings and/or its nominee/s for transfer of the sale shares, together with the share certificates in respect of the sale of shares

9.1.2 A certified copy of a resolution of the directors of Jones Holdings recording their approval of the transfer of the sale shares to PG Merchandising;

9.1.3 A cession in writing, of Jones Holdings loan account, if any, duly signed on behalf of Jones Holdings ceding all right, title and interest in and to Jones Holdings loan account to PG merchandising.

9.1.4 Letters addressed to Zimtile by two directors nominated as directors by Jones Holdings, tendering their resignations as officers of the company.

More over in terms of clause 12, PG merchandising was bound by stipulated undertakings regarding Zimtile until the purchase price had been paid. It is on the basis of the above clause that the respondent argues it was a secured creditor as it retained possession of title until the shares were fully paid for.

The respondent's grievance was considered by the Chairperson of the Scheme meetings who arrived at the conclusion that the respondent was not a secured creditor premised on the absence of a pledge agreement and a perfection of that security. The chairpersons report filed 29 January 2014 captured the resolution of the claim and status of Jones Holdings as follows in arriving at the conclusion that it was an unsecured creditor.

"26.1 That the retention of the shares sold without a bilateral cession and pledge agreement in respect of the shares, perfected by delivery of the shares in negotiable order would not be sufficient to make Jones Holdings a secured creditor.

26.2 No such documents above having been made available to the company before the meeting or handed over to me at the meeting, my decision for purposes of the meeting was that the creditor was not secured and was therefore a concurrent creditor.

26.3 As regards quantum the record date for the purposes of the meeting was the 30th of September 2013 and claims would be treated as they appeared in record books of the company as at that date. I further made the point that in general, I would consider values as referring to capital rather than interest. However nothing turned on this aspect."

Given the fact that Jones Holdings claim for preferential consideration had been considered by the Scheme Chairperson, Mr *Mpofu* argued that that there is no statutory procedure which allows the court to interfere with a determination made by the Chairperson of the statutory meetings. He maintained that the only remedy would have been by way of review of the Chairmen's decision. He also argued that in any event the respondent had been engaged in negotiations with the applicant to collaterise the debt proving that it was not a secured creditor. He was emphatic that the Chairman's position was unassailable that what was needed to make the agreement a security was a cession of the shares and a pledge of shares to the respondent and that this had not taken place.

Since the court is not merely there to rubber stamp, it follows that the essence of a grievance if presented to the court must at least be engaged with regardless of the position that will have been taken by the Chairman of the Scheme meetings. After all the aim of the court in its scrutiny is to ensure that a scheme is not manifestly unfair.

The respondent argues that the insolvency Act [*Chapter 6:04*] defines in s 2, a secured creditor as one who "has a preferment right by virtue of any special mortgage, landlord's hypothec or right of retention. It argues that one form of retention is a debtor creditor lien and that it has the right to retain the buyer's shares until the buyer has paid all that is due under the contract.

A party who wants to secure protection against claims by third parties to the collateral must secure their interest. For a creditor to have maximum legal rights, the security agreement must not only be created but that it must also be perfected. The parties must intend that security of interest be created by the agreement in question. But a security agreement alone will not create a security of interest unless it is perfected. Perfection can generally be through possession depending on the nature of the collateral or execution of specific documents. Once such security of interest is created and perfected then it is enforceable against third parties. If there is an agreement and it is unperfected then the creditor remains subordinate to other secured creditors.

In casu the issue is whether the clause in the agreement of sale out rightly created a security of interest which was perfected. In other words, the issue is whether adequate steps were taken that would be sufficient to put third parties on notice that respondent is a preferential creditor.

Clearly conscious of the risks of selling the shares on a credit basis, the respondent took the added precaution of inserting a clause on retention of title until the payment of the full purchase price. In my view the security clause that was inserted, though material in many respects regarding its intention, as a creditor cannot be said to have sufficiently constituted a security of interest that was perfected. For instance, there was no specific share pledge agreement that was subsequently executed accompanied for instance by a resolution from the board of directors of PG Merchandising approving the pledge of shares pending full payment of the purchase price to Jones Holdings. The debtor must authenticate the security agreement. If, as Mr *Ochieng* described, this is a debtor/creditor lien, then the debtor should have subsequently signed a specific agreement giving it rights to the purchased property and agreeing to use it as collateral.

Since it cannot be said that the totality of the writing in the sale agreement was sufficient to constitute a perfected security of interest, the absence of a more specifically dedicated security agreement makes the chairman's position unassailable. Building onto the understanding captured in the sale agreement, to make Jones Creditors a secured creditor, what was subsequently necessary was as he put it "a bilateral cession and pledge agreement in respect of the shares, perfected by delivery of the shares in negotiable order". Stocks and shares are incorporeal and their transfer is through an instrument in writing. As RH Christie observes in his book *Business law in Zimbabwe* at p 450, to create a pledge of incorporeal things, cession takes the place of delivery. Thus even if there was an agreement to create a security of interest, the agreement alone did not perfect the interest.

The respondent's grievance in seeking to have the scheme set aside does bring to the fore the rationale behind the Company's Act providing in the manner that it does in s 191(2), some indicator of what the court should look out for to be sufficiently satisfied to sanction a scheme. Evidently the difficulty of obtaining the consent of each individual is core to allowing the sanctioning of the scheme on the basis of majority approval. While a court generally cannot refuse to sanction a scheme where the requisite majority have approved it, where cogent reasons are placed before it as to why it should not, it obviously has a duty to consider the objections placed before it in arriving at its final conclusion since once a court sanctions a scheme, it is binding on dissenters and apathetic members.

It cannot be down played that in reality a scheme of arrangement necessarily requires some give and take on the part of all those involved. It is for this reason that the statutory position should ultimately be central beam in assessing whether or not to sanction a scheme. The requisite guideline, namely the approval of a scheme by three quarters of creditors or class or creditors, or members or class of members, is there as a beacon to assist the court in its assessment of the general acceptance of the scheme. It is a yardstick that is crucial for the court to arrive at a conclusion whether or not it can or should dispense with the need of unanimous consent by way of a court order.

While the provision which permits the court to sanction a scheme does in indeed leave room for possible refusal, in my view that it would be in very exceptional circumstances that the court would allow a scheme to override the interests of the majority on account of a single creditor whose debt is comparatively minimal when assessed in light of the overall debt owed to the consenting majority. In any case it would open the flood gates for litigation were the court to start playing business rather than legal umpire in such matters. Courts are indeed ill equipped to set aside a scheme of arrangement that will have been thoroughly considered by those with the requisite business interest. Whilst dissentient voices have a right to be heard, a case of unfairness would need to be truly manifest to justify a deviation from the norm which is ordinarily that of according those who would have voted in favour of the scheme, a chance to see it to fruition. After all, often at the core of a scheme of arrangement necessitated by economic hardship, is the desire to the return a company's operations to a sound footing which will result in a win - win situation for all involved. This includes creditors and shareholders alike.

The papers reveal that the parties have been engaged in some dialogue, albeit without closure, ever since the issue of the respondent's standing as a creditor was surfaced. There is nonetheless some discernible common ground among the two parties, if, as applicant's counsel pointed out in arguing that the respondent's debt was indeed unsecured, the respondent has been engaged in discussions to secure its debt. Opening the door to negotiations would suggest some appreciation on the applicant's part that the respondent's position is not entirely without merit and that there is some grasp that the respondent cannot be at par with creditors for utility bills. It is apparent from the agreement that the intention behind the insertion of the retention clause was seemingly to create a security of interest though admittedly it was not a perfected. It was also respondent's averment in its papers that on 13 March 2014 the applicant's finance director advised by email that he had engaged Interest Research Bureau (IRB) to do a calculation of the respondent's claim and that the final order to shareholders for the EGM excluded Zimtile from divisionalisation; allegedly in recognition of the amount due to respondent. It was however not made privy to the final decision. It is for the parties therefore to pursue to their logical conclusion the initiatives that have been set motion. There will be no order as to costs.

Since the primary purpose of this application is for this court to assess whether the law's requirements to enable it to sanction the scheme of arrangement have been met, this court finds no reason that is sufficiently compelling to deny applicant the sanctioning of its scheme.

Accordingly it is ordered that:

1. The scheme document of PG Industries (Zimbabwe) Limited attached as annexure B thereto, be and is hereby modified as follows:

    1.1 by the deletion of the first paragraph in clause 2.1.1 and its replacement with the following:

    "The company owes $5.3 million to secured lenders (see appendix 3). The secured lenders Scheme comprises:

    a) A swop of the debt owed by PGIZ to their lenders with immovable properties on mutually agreed valuations and other terms and conditions; or

    b) A deferred payment plan to settle amounts owed on the following terms:

    Facility type Amortised Loan

    Tenure: 36 months from date of the Court sanction of the scheme

    Standstill period; 3 months

    Settled period: All amounts owed including accrued interests will be amortised on monthly basis over 33 months following the standstill period.

    Interest rate: An all in interest rate of 12% per annum.

    Security: Immovable properties".

    1.2 By the deletion of paragraph (b) from clause 2.1.3 and any reference in clause 2.1.3 to an option.

2. The Scheme of Arrangement proposed by PG Industries (Zimbabwe) Limited as modified in terms of this court order be and is hereby sanctioned in terms of section 191(2) of the Companies Act (*Chapter 24: 03*)".

Dube, Manikai & Hwacha, applicant's legal practitioners
Atherstone and Cook, respondent's legal practitioners