

Corporate Debt, Turnaround & Restructuring

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SOUTH AFRICA

To institute or not to institute liquidation proceedings (that is the question)



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To institute or not to institute liquidation proceedings (that is the question)

It is a well-established principle in our law that insolvency/liquidation proceedings are not meant to be used for the recovery of a debt – the courts regard this as an abuse of (legal) process. Rather, the purpose of insolvency proceedings, as per *Trengove AJ in Investec Bank Ltd and Another v Mutemeri and Another* (O9/22247) [2009] ZAGPJHC 64 is “to bring about a convergence of the claims in an insolvent estate to ensure that it is wound up in an orderly fashion and that creditors are treated equally”.

This issue is heightened in the case of a disputed debt, where the requirement for a successful application to court to wind up a company is that the debt be undisputed. If the debt is disputed, and by this is meant a *bona fide* (genuine) dispute, then the creditor must pursue an action (by way of summons) against the debtor, or else the court will inevitably dismiss the liquidation application.

In the recent case of *Greenco Projects and Construction CC v Hermanus Esplanade Dev Co (Pty) Ltd* [2024] JDR 2573 (WCC), the court considered whether a liquidation should be granted and, in particular, whether the debt was disputed. The case is useful in grappling with what constitutes a *bona fide* dispute. It also deals instructively with the status of disputed payment certificates in a construction context.

The *Badenhorst* rule

As established in the case of *Badenhorst v Northern Construction Enterprises (Pty) Ltd* [1956] (2) SA 346 (T), liquidation proceedings ought not to be used to enforce payment of a debt, the existence of which is *bona fide* disputed by the company on reasonable grounds. The procedure for liquidation is not designed for the resolution of disputes as to the existence or nonexistence of a debt. This is known as the *Badenhorst* rule.

Where *prima facie* the indebtedness exists, the onus is on the respondent to show that it is *bona fide* disputed on reasonable grounds. Where this onus is discharged, the liquidation application should fail, even if it appears that the company is nevertheless unable to pay its debts.

The respondent must satisfy two requirements, namely, its *bona fides* and the reasonableness of the grounds relied upon. *Bona fides* relate to the respondent’s subjective state of mind, while reasonableness is whether, objectively, the facts alleged by the respondent constitute a defence in law.



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Bona fide disputes

In determining whether Grenco's claim was *bona fide* disputed by Hermanus, the court considered:

- whether a defence to Grenco's claims underlying certain payment certificates was raised by Hermanus *bona fide* and on reasonable grounds;
- whether as a matter of general principle interim payment certificates are immune to attack; and
- whether the effect of certain clauses of the Joint Building Contracts Committee (JBCC) contract was that the amounts certified in the payment certificates must be paid notwithstanding that they may be overturned in the arbitration, even if the answers to the above two issues are in the affirmative.

On the first issue, Hermanus, through an expert, put up evidence that Grenco's failure to achieve practical completion was due to its own fault by, for example, placing a crane that blocked the entrance to the construction site so that when the removal of the crane was delayed, contractors were unable to access the site and construct the services during the period of the delay.

Hermanus' evidence effectively went unchallenged by Grenco and as a result the court found that Grenco's claims underlying the payment certificates were *bona fide* disputed by Hermanus on reasonable grounds. The court held further that while this finding was necessary for Hermanus to satisfy the *Badenhorst* rule, it was not enough – Hermanus also needed to satisfy the court that even if such an underlying defence was accepted, the payment certificates were not immune from attack.

Regarding the second issue, the court held that there was authority to the effect that defences could be raised to interim payment certificates, including set-off or a counterclaim for damages. Thus, the clause requiring payment in terms of the payment certificate did not have the consequence that payment should be made pending determination of the underlying dispute in arbitration. The court held that payment certificates are, as a matter of general principle, not infallible and are not immune from dispute.

Finally, on the issue of whether the amounts certified in the payment certificates should be paid, notwithstanding that they may be overturned in an arbitration, the court emphasised that there is an important distinction between whether there is a *bona fide* dispute on reasonable grounds (i) of the claim for payment and (ii) of the claims underlying those payment certificates.

If payment is not to be made in the context of pending arbitration proceedings and the dispute of the claims underlying the payment certificates have been made *bona fide* and on reasonable grounds, then the application for liquidation should be dismissed.



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Cliffe Dekker Hofmeyr

However, if payment is to be made, notwithstanding pending arbitration proceedings, and the dispute of the claims underlying the payment certificates have been made *bona fide* and on reasonable grounds, then the question is whether the existence of these two factors means that the claim for payment in terms of the payment certificates *per se* is disputed *bona fide* and on reasonable grounds, or whether the applicable clauses compel payment notwithstanding the existence of these two factors.

The answer contemplates whether there are any clauses in the contract that “give the interim certificate the character of something that vests an absolute or temporarily final right to payment of the amount certified thereby if there is a dispute.” In other words, the question is whether, pending the determination of a dispute in an arbitration, the clauses of the agreement relied on by the applicant require payment.

Finding

The court found that the effect of the clauses was that payment should be made pending arbitration, notwithstanding that Hermanus had established that the claims underlying the payment certificates were *bona fide* disputed on reasonable grounds. The court therefore concluded, by weighing up the three considerations set out above, that Grenco’s claim for payment in terms of the payment certificates was not disputed on *bona fide* and reasonable grounds.

The court, while exercising its discretion to grant an appropriate order, rather than dismissing the application, held that the liquidation application should be stayed pending finalisation of pending arbitration proceedings, and Hermanus was ordered to pay the costs of the application as Grenco had ultimately made a case for liquidation.

Despite the liquidation application being stayed in this instance, a creditor should always carefully consider whether it should institute liquidation proceedings when the debt in question may be *bona fide* disputed. This can be a complex issue to be determined by the facts of the matter and the relevant contractual provisions. The consequences of getting this wrong will inevitably be the dismissal of the liquidation application, with costs awarded against the applicant.

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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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