LIQUIDATING A DEBTOR EVEN THOUGH ADEQUATE MORTGAGE SECURITY FOR THE DEBT IS IN PLACE?

Imobrite (Pty) Ltd v DTL Boerdery CC (1007/2020) [2022] ZASCA 67 (13 May 2022)

This was the niggly question before the court here. The lender had brought proceedings to wind up the debtor, a CC, despite having both a notarial bond over the CC's movables and a mortgage bond over the CC's farm property. These were substantial enough to satisfy the outstanding debt and the CC argued therefore that the lender's action was an abuse of the court's processes. But was it? The court looked at all the circumstances, especially the fact that not even one repayment instalment was made and that no effort was made to address the debt, and found in favour of the lender.

The Judgment can be viewed here.

FACTS

During 2018, Imobrite (Pty) Ltd (Imobrite) advanced R2,750,000 to DTL Boerderye CC (DTL) and its sole member, Kotze. The loan terms were recorded in an Acknowledgment of Debt (AOD) which noted, amongst other things, that the CC and Kotze would repay the capital plus interest thereon in ten yearly instalments of some R790,000. The AOD also stipulated that in the event that the debtor remained in default 10 days after receiving notice to repair the breach, then Imobrite, as the creditor, would be entitled to exercise any remedy at its disposal in terms of the law, including to cancel the agreement and retain all payments already made. (A facilitation fee was also included.)

The debt was secured: Imobrite held a special and general notarial bond over DTL's movable assets for an amount of R2,750,000. In addition, a bond had been registered in favour of Imobrite over a farm registered in DTL's name.

DTL failed to pay the first instalment by the due date. As a result, Imobrite delivered a letter of demand to DTL. On 20 May 2019, Imobrite sent a letter to DTL, drawing its attention to its failure to pay the first instalment in accordance with the AOD. DTL indicated that it would make a plan to arrange for financing with which to pay off the debt. It also disputed the calculation of the interest and facilitation fee. Nothing further came of this.

In June 2019, Imobrite issued a statutory demand (as contemplated in section 69 of the Close Corporations Act, 69 of 1984 (the CC Act)). The Sheriff properly served the demand on DTL. Its attorneys then sent a letter to Imobrite's attorneys and stated that it disputed its indebtedness to Imobrite.

In September 2019, Imobrite launched an application for the winding-up of DTL in the Mahikeng High Court, on the basis that DTL was unable to pay its debts. DTL defended the matter arguing, in essence, that Imobrite was abusing the winding-up proceedings in order to enforce a debt for which it in fact enjoyed adequate security. The High Court agreed with DTL. Imobrite appealed.

HELD

Legal position

- The winding-up of a Close Corporation is regulated by section 66 of the CC Act, which also records which parts of the Companies Act 61 of 1973 applies to the winding up of close corporations. Section 66(1) of the CC Act states:

'(1) The laws mentioned or contemplated in item 9 of Schedule 5 of the Companies Act, read with the changes required by the context, apply to the liquidation of a corporation in respect of any matter not specifically provided for … in … this Act.'

- Section 66(2) provides further that for the purposes of section 66(1), any reference in a relevant provision of the Companies Act, and in any provision of the Insolvency Act 24 of 1936, made applicable by any such provision to a company, shall be construed as a reference to a corporation.

- The CC Act provides further that for purposes of winding up of a close corporation, the corporation shall be deemed to be unable to pay its debts, if-

  "69 (a) a creditor …to whom the corporation is indebted … has served on the corporation, by delivering it at its registered office, a demand requiring the corporation to pay the sum so due, and the corporation has for 21 days thereafter neglected to pay the sum or to secure … it to the reasonable satisfaction of the creditor; or

  (b) any process issued on a judgment … or order of any court in favour of a creditor of the corporation is returned by a sheriff … with an endorsement that he or she has not found sufficient disposable property to satisfy the judgment …or that any disposable property found did not upon sale satisfy such process; or

  (c) it is proved to the satisfaction of the Court that the corporation is unable to pay its debts."

- The requirements set out in section 69 above need not be met cumulatively; any one of those requirements will suffice.

- In this matter, it is common cause that in order to establish the requirement that the CC was unable to pay its debts, Imobrite relied upon the CC's inability to pay an undisputed debt within the statutorily allowed period of 21 days after receiving the statutory demand as set out in section 69, quoted above.

- Section 344 of the 1973 Companies Act is the source of authority that vests a court with the power to liquidate a company. The relevant part provides that a court may grant or dismiss any such application, or adjourn the hearing thereof, conditionally or unconditionally, or make any interim order or any other order it may deem just.

Interpretation of section 69 of Close Corporations Act and 'securing' the debt in the context thereof

- The language in section 69(1)(a) of the CC Act is clear and unequivocal. On a plain reading of that provision, it is evident that a creditor will be entitled to rely upon the deeming provision if the close corporation has for 21 days after the demand has been made, neglected to either pay the sum due to the creditor, or to secure or compound for it to the reasonable satisfaction of the creditor.

- 'Secure' within the context of this section means that the close corporation must provide security or additional security which is to the creditor's satisfaction within 21 days after the statutory demand.

- To interpret the section as meaning that the deeming provision will not apply if, prior to the demand, the creditor already had sufficient security to cover the debt would be to strain the clear language of the section. It would mean that many creditors, such as financial institutions that regularly procure security to secure debts, would hardly be able to rely upon the deeming provision, and thus, the winding-up process would never be available to them. That meaning would simply lead to insensible or unbusinesslike results. The High Court's interpretation of section 69(1) was plainly wrong.

Was Imobrite's conduct in bringing the application for winding-up an abuse of the court process?

- It is trite that, by their very nature, winding-up proceedings are not designed to resolve disputes pertaining to the existence or non-existence of debts. Thus, winding-up proceedings ought not to be resorted to for enforcing a debt that is *bona fide* (genuinely) disputed on reasonable grounds. That approach is part of the broader principle that the court's processes should not be abused.

- A winding-up order will not be granted where the sole or predominant motive or purpose of seeking the winding-up order is something other than the *bona fide* bringing about of the company's liquidation. It would also constitute an abuse of process if there is an attempt to enforce payment of a debt which is bona fide disputed, or where the motive is to oppress or defraud the company or frustrate its rights.

- In this matter, it was clear that DTL had no valid defence against the claim. First, not a single instalment had been paid in repayment of the debt. Second, the indebtedness in respect of the capital amount was not disputed at any stage; instead, DTL's claim that the debt was incorrectly calculated was based on the alleged miscalculation of interest and the facility fee. Notably, despite remaining in default beyond the 21-day period stipulated in the statutory demand, DTL failed to tender to pay what is considered to be the correct amount, nor did it make any suggestions regarding how to discharge its indebtedness (save to mention once that it would obtain alternative financing once the amount of the debt had been corrected). Under these circumstances, there can be no merit in the suggestion that Imobrite was attempting to enforce payment of a debt which was *bona fide* disputed. That being the case, it cannot be accepted that Imobrite's application was predicated on any reason other than the *bona fide* bringing of winding-up proceedings. Therefore, DTL had not shown that the winding-up proceedings constituted an abuse of the court's process.

The exercise of the discretion to grant a winding-up order

- DTL argued that because Imobrite had a mortgage over its movable and immovable property, there was adequate assets to address the outstanding debt upon execution and that the court should have exercised a discretion to not grant the winding-up order sought by Imobrite.

- Two types of discretion exercised by courts are often referred to as a discretion in the strict/narrow/true sense and a discretion in the broad/wide/loose sense. In the context of an application for business rescue, our courts have observed that the term 'discretion' is sometimes used in the loose sense to indicate no more than the application of a value judgment. Where the 'discretion' exercised by the lower court was one in the loose sense of a value judgment, the limitation imposed on the authority of the court of appeal to interfere does not apply. In that event the court of appeal is both entitled, and in fact duty-bound, to interfere if it would have come to a different conclusion.

- Our courts have affirmed in various judgments that an unpaid creditor has a right, *ex debito justitiae* (as of right), to a winding-up order against a company that has not discharged its debt. Notably, it also reaffirmed the trite principle that the refusal of a winding-up order under such circumstances entails the exercise of a narrow discretion, and the mere fact that there may be more value than the claim is not, without more, sufficient to sway a court towards exercising the discretion in favour of a debtor. This is because our law has always held that there is good reason why a company's commercial insolvency usually justifies an order for its liquidation: the valuation of assets, other than cash, is a notoriously elastic and often highly subjective one; the liquidity of assets is often more viscous than recalcitrant, debtors would have a court believe; more often than not, creditors do not have knowledge of the assets of a company that owes them money - and cannot be expected to have; and courts are more comfortable with readily determinable and objective tests such as whether a company is able to meet its current liabilities than with abstruse economic exercises as to the valuation of a company's assets.

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- In summing up, it bears emphasising that the exercise of discretion in favour of not granting a liquidation order must be based on a solid factual foundation. As mentioned in the foregoing paragraphs, that factual foundation is missing from the facts presented by DTL . In the face of a compelling case made by Imobrite for granting a winding-up order, DTL did not raise a *bona fide* defence to the claim.

- It is well-established that an appellate court may interfere with the exercise of a discretion in the true sense by a court of the first instance only if it can be demonstrated that the latter court exercised its discretion capriciously or on a wrong principle, or had not brought an unbiased judgment to bear on the question under consideration, or had not acted for substantial reasons.

- The High Court's judgment accepted that there was no dispute regarding DTL's indebtedness but made much of the fact that Imobrite held securities in the full amount of the principal debt, which prompted it to exercise the residual discretion not to grant the winding up order.

- In the absence of facts supporting the exercise of a discretion in favour of DTL, there was no justification for the High Court refusing to grant the winding-up order.

CONCLUSION

It follows that the appeal succeeded. A provisional order for the winding up of DTL was granted.

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