

## CONSTRUCTION LAW BULLETIN

### THE MAIN CONTRACTOR IS LIQUIDATED: CAN THE EMPLOYER CANCEL?

#### INTRODUCTION

The liquidation of a company does not, save for certain exceptions which are not relevant to this discussion, terminate contracts to which the company is a party.

Upon the grant of a final liquidation order in respect of a company, a state of affairs described as the *concurso creditorum* comes about. What this means is that the relationships between the company and its creditors and amongst the creditors themselves are frozen. In other words the rights and obligations of the various parties are fixed and no one is entitled to change his position for better or for worse.

The Companies Act<sup>1</sup>, as read with the Insolvency Act<sup>2</sup>, regulates the position in relation to certain specified contracts. Construction contracts are not one of these, and the consequences of liquidation for them are governed by the common law.

In terms of the common law, upon liquidation executory contracts<sup>3</sup>, of which construction contracts are one, are not terminated. The contracts continue. However, an employer cannot compel the contractor's liquidator to continue with and complete the contract.<sup>4</sup> This is often referred to as the liquidator's right to elect not to perform or to repudiate the contract.

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<sup>1</sup> Act 61 of 1973.

<sup>2</sup> Act 24 of 1936.

<sup>3</sup> Namely contracts in respect of which there are outstanding obligations to be performed.

<sup>4</sup> Meskin, *Insolvency Law*, para 5.21.1.

A point to remember is that the *concurso creditorum* arises in respect of a company that is placed into liquidation with effect from the date that the liquidation application papers are filed in court<sup>5</sup> at the commencement of the proceedings although this is only triggered when the final liquidation order is granted by the court much later.

#### THE PROBLEM

In the days and weeks leading up to its liquidation, a contractor is usually under-performing and as a result penalties are likely accruing and the employer is facing looming losses, *inter alia* with respect to accruing financing costs and the like.

It is in the employer's interests to stop the rot as it were by terminating the contract and getting a new contractor on board to complete the job as soon as possible.

The likely scenarios are that the employer:

- has given a breach notice to the contractor and the period allowed for the contractor to cure its breach has expired but no notice of cancellation has been issued by the time the liquidation occurs<sup>6</sup>; or
- has given a breach notice but the cure period has not yet expired by the time liquidation intervenes; or

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<sup>5</sup> i.e. the application is launched.

<sup>6</sup> i.e. the *concurso creditorum* arises.

- has not by the time liquidation intervenes given any breach notice but wishes nonetheless to do so as a precursor to cancelling.

### THE LAW

In the first scenario, namely where an employer has given a breach notice to a contractor under the construction contract and the contractor has failed to remedy its breach by the time the application for its liquidation is launched, the employer's right to cancel has accordingly accrued prior to insolvency and the law permits the employer to proceed to cancel the contract despite the intervening liquidation of the company.<sup>7</sup>

In this scenario our courts have said that it is a basic principle that a contract survives the insolvency of a contracting party and therefore it follows that an accrued right to cancel also survives such insolvency.<sup>8</sup>

In the second scenario the employer has given a breach notice prior to liquidation but the time period allowed to the contractor to remedy its breach only expires after liquidation has occurred. In this scenario our courts have held that the liquidation<sup>9</sup> does not affect the breach notice issued by the employer nor prevent the employer after the expiry of the notice period, albeit that this is after liquidation, from cancelling.<sup>10</sup>

In this context our courts have said that there is nothing in our law which excuses the liquidator from performing the insolvent's obligations which fall due to be performed between the date of liquidation and the date upon which the liquidator makes his election whether or not to continue with the contract. In other words, should the liquidator during this period fail to perform the liquidated contractor's obligations, the liquidator cannot challenge the employer's right of cancellation.

In the third scenario the employer has not given a breach notice prior to liquidation or perhaps has given such a notice simultaneously with liquidation. This occurred in the Thomas Construction case.<sup>11</sup>

The breach notice in this case was given by the employer on the same day that the liquidation application was launched or the date that the *concursum creditorum* occurred.

<sup>7</sup> Smith and Another v Parton 1980(3) SA 724 D.

<sup>8</sup> Smith v Parton op cit at 729.

<sup>9</sup> i.e. the *concursum creditorum*.

<sup>10</sup> Porteous v Strydom NO 1984(2) SA 489 D.

<sup>11</sup> Thomas Construction (Pty) Ltd (in liquidation) v Grafton Furniture Manufacturers (Pty) Ltd 1986(4) SA 510 N.

The court stated that liquidation is not designed to endow the liquidator with rights under the contract greater than those of the insolvent whose place he is taking. Based on this principle the court made two important rulings, namely that:

- a clause in the construction contract providing that upon cancellation the employer was under no obligation to make any further payments to the contractor pending completion of the contract and a final accounting was valid and binding as against the liquidator even in relation to prior interim payment certificates issued which were unpaid; and
- it is immaterial whether the employer's pre-cancellation breach notice calling on the contractor to perform is issued before or after the liquidation. In other words, it is competent for an employer to give a breach notice to the liquidator and if he fails to remedy the relevant breach within the time allowed, the employer can cancel.

This latter ruling can be of great benefit to an employer because invariably liquidators can take weeks if not months to decide on whether or not to complete the contract or walk away from it.

The Thomas Construction case was taken on appeal to the Supreme Court of Appeal in Bloemfontein<sup>12</sup> and the Appeal Court did not express any contrary opinion on this issue, partly due to the fact the senior counsel representing both parties accepted the proposition as being correct.

### CONCLUSION

Whilst the matter cannot be said to be entirely free from doubt, it does appear that employers can force liquidators to expedite their decision as to whether to continue performing under a construction contract or not by issuing a breach notice to the liquidators and if they fail to respond, then proceed to cancel the contract and appoint a new contractor to complete the job.

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<sup>12</sup> Then known as the Appellate Division, reported in 1988(2) SA 546 A.