

**The position of 'low income low asset' (LILA) debtors  
in South Africa: the need for legislative reform**

**by**

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**I certify that the whole research paper, unless specifically indicated to the contrary in the text, is my own work. It is submitted as part of research component in partial fulfilment for the degree of Masters in Business Law (LLMBL) in the School of Law, University of KwaZulu-Natal, 2015.**

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## **Dedication**

I dedicate this dissertation to my late parents Mac-Charles and Catherine Manyuni. May their loving and caring souls rest in eternal peace. Greatly missed!!

To my future family!!

## **Abstract**

Consumer over-indebtedness affects anyone in the world whether rich or poor. However, it is a common feature amongst the poor or rather the low income earners, since they will from time to time find other means to subsidise the little that they have. They achieve this through borrowing money from loan sharks who instead of assisting them from their over-indebtedness worsen their position through interests from these loans. As any other consumer debtor they deserve protection not just protection but equal and appropriate protection in order to obtain debt relief. In South Africa there are three debt relief mechanisms at the disposal of debtors these are found under the Insolvency Act of 1936, the Magistrates' Court Act of 1944 and the National Credit Act of 2005. This dissertation seeks to examine the South African consumer insolvency and debt relief legislative provisions. This will be done in order to ascertain whether these legislative provisions appropriately provide debt relief to LILA debtors. Failure to find adequate provisions for the relief of LILA debtors in South Africa this study will endeavour to ascertain if whether there may be appropriate debt relief mechanisms in foreign jurisdictions which have the potential of granting a LILA debtor debt relief. This comparative study will be done on countries such as the United States of America, England and Wales to name but a few. This comparative study is of importance since it will give lessons to South Africa on how to address the position of LILA debtors in regard to providing them with debt relief.

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## CHAPTER ONE: INTRODUCTION

‘...the borrower is servant to the lender’

The book of Proverbs<sup>1</sup>

### 1.1 Background

In South Africa, as in other jurisdictions across the globe,<sup>2</sup> consumer over-indebtedness is a major concern. For a large proportion of the South African population, over-indebtedness keeps them in a type of ‘debt servitude’ in that they spend their lives working to earn money to pay their debts, with minimal, if any, disposable income to apply towards subsistence needs, let alone to improve their standard of living. For these debtors, who are mainly *de facto* insolvent, the South African law falls short of what is required to address appropriately the problems arising out of and constituted by consumer over-indebtedness and insolvency. This is in spite of the existence of: the Insolvency Act,<sup>3</sup> which regulates the sequestration of the estates of individual debtors; section 74 the Magistrates’ Courts Act<sup>4</sup> (MCA), which provides for the administration of debt the total amount of which does not exceed R50 000; and the National Credit Act<sup>5</sup> (NCA), which provides for debt review and restructuring by the magistrate’s court of debts arising out of credit agreements.

The debt relief mechanisms in South Africa offer little or nothing to debtors who have low income and minimal assets. Such debtors may be referred to as ‘low asset low income’ (LILA) debtors. They have little to offer towards meeting a judgment debt and or monetary obligations. As such, LILA debtors may be regarded as falling under the same category as so-called ‘no income no asset’ (NINA) debtors, who similarly cannot pay anything towards fulfilling their debt obligations.<sup>6</sup> The effect of the Insolvency Act’s strict requirement that sequestration should be to the ‘advantage of creditors’ precludes certain types of debtors, and,

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<sup>1</sup>King James Version Chapter 22 verse 7 (Jewish and Christian Bible).

<sup>2</sup>Examples of such jurisdictions are United States of America, England and Wales, Scotland, and Ireland.

<sup>3</sup>Act 24 of 1936.

<sup>4</sup>Act 32 of 1944.

<sup>5</sup>Act 34 of 2005.

<sup>6</sup>For discussion of the position and treatment of treatment NINA debtors in South Africa, see H Coetzee and M Roestoff ‘Consumer debt relief in South Africa – Should the Insolvency System provide for NINA debtors? Lessons from New Zealand’ 22 *Int. Insolv. Rev* (2013) 188. See also discussion of NINA debtors, Working Group on the Treatment of the Insolvency of Natural Persons *Report on the treatment of the insolvency of natural persons* (Insolvency and Creditor/Debtor Regimes Task Force, World Bank) par 297 available at [http://siteresources.worldbank.org/INTGILD/Resources/WBInsolvencyOfNaturalPersonsReport\\_01\\_11\\_13.pdf](http://siteresources.worldbank.org/INTGILD/Resources/WBInsolvencyOfNaturalPersonsReport_01_11_13.pdf) accessed on 28 December 2014 – hereafter the *World Bank Report*.

typically, LILA debtors, from having their estates sequestrated. This is because it is required to be proved that some pecuniary benefit will result to creditors if the estate is sequestrated. This in turn means that LILA debtors would never have the opportunity of having their pre-sequestration debt discharged upon rehabilitation in terms of the Insolvency Act. Rehabilitation is a process which takes place after sequestration of a debtor's estate which has the effect of discharging all pre-sequestration debts and relieving the debtor of every disability resulting from sequestration.<sup>7</sup> This aspect of South African insolvency law serves in part to provide insolvent debtors with a 'fresh start', as it is known in American parlance, by granting them debt discharge after they have partially met their financial obligations. A fresh start '...is about the debtor beginning again on the economic treadmill; having a restored ability to participate in the open credit economy; restoring their "financial well-being", or obtaining longer term financial health'.<sup>8</sup> Both the administration system, in terms of section 74 of the MCA, and the NCA's debt review and debt re-arrangement provisions provide debt relief to a certain type of debtor as has been pointed out above. These procedures require all debts to be paid in full. They do not contain any provision for debt discharge and thus do not provide debtors with a 'fresh start' in the sense that rehabilitation does.

At present, South African insolvency law does not provide for appropriate informal out of court debt settlement or rearrangement. The current debt relief measures are characterised by formal court proceedings. In order for a debtor to be declared insolvent and have his or her estate sequestrated he or she has to lodge an application in the High Court.<sup>9</sup> A debtor has to lodge an application in the magistrate's court for an administration order.<sup>10</sup> A debt counsellor, who will also charge a fee, has to make a recommendation to the magistrate's court in order for a debtor to have his or her debt re-arranged in terms of NCA.<sup>11</sup> This, in effect, bars most LILA debtors from obtaining debt relief as they do not have money to afford legal representation and to meet the court costs and other fees. As a result, most over-indebted LILA debtors seek other, unfavourable options to pay off their debts, such as borrowing from loan sharks. Loan sharks take advantage of the unfortunate situation of LILA debtors and impose unreasonably high interest rates. This, together with all the other debts due, make the life of a LILA debtor miserable. Thus the effect of the restrictions in each of the range of

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<sup>7</sup>S 129(1) of the Insolvency Act.

<sup>8</sup>N Howell 'The fresh start goal of the Bankruptcy Act: Giving a temporary reprieve or facilitating debtor rehabilitation' 14 *QUT Law Review* (2014) 29, 32. See also discussion in the *World Bank Report* (note 6 above) par 359.

<sup>9</sup>S 3 of the Insolvency Act.

<sup>10</sup>S 74(1) (b) of the MCA.

<sup>11</sup>S 86(7) (c) of the NCA.

applicable provisions, viewed as a whole, is that LILA debtors, who often need debt relief the most, cannot access it.

A question is therefore posed whether LILA debtors should be afforded the same treatment as other debtors who obtain debt relief under the mechanisms that are currently available? In terms of the Constitution,<sup>12</sup> South Africa is a democratic state. One of the founding values of the Constitution is the achievement of equality<sup>13</sup> and it would seem that the legislature has not adequately provided ‘equal debt relief’ for LILA debtors.

## 1.2 Problem Statement

This paper will examine the South African consumer insolvency and debt relief legislative provisions. It seeks to identify the lacunae in the South African legal system which fails to provide debt relief to LILA debtors. Further, it will endeavor to ascertain whether there are appropriate measures which may be introduced or adopted from other foreign jurisdictions to cater for LILA debtors. A comparative study of the position in the United States of America (USA), England and Wales, Scotland, Ireland and New Zealand, specifically focusing on legislative provisions offering more debtor friendly relief mechanisms to a LILA debtor, and a measure of debt discharge, will be undertaken. This comparative study is important since it will show how these jurisdictions have enhanced their debt relief legislative measures, which are able appropriately to accommodate most types of debtors, including LILA debtors. For example, according to Evans,<sup>14</sup> the American bankruptcy system is different from a number of debt relief regimes. Unlike the South African regime, which hinges on the requirement that sequestration should be to the ‘advantage of creditors’,<sup>15</sup> American policy is based on providing a debtor with a ‘fresh start’.<sup>16</sup> Studying insolvency and consumer debt related legislation applicable in foreign jurisdictions, including reforms brought about there, and, more specifically, provisions applicable in respect of debtors who have low income and possess few material assets, may provide valuable pointers and guidance regarding possible appropriate statutory reform in South Africa.

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<sup>12</sup>Act 108 of 1996.

<sup>13</sup>Ibid Chapter 1(a).

<sup>14</sup>R G Evans ‘A brief explanation of consumer bankruptcy and aspects of the bankruptcy estate in the United States of America’ *The Comparative and International Law Journal of Southern Africa* (2010) 337, 337.

<sup>15</sup>See also s 6, 10 and 12 of the Insolvency Act. A Boraine and C van Heerden ‘To sequestrate or not to sequestrate in view of the National Credit Act 34 of 2005: A tale of two judgments’ *Potchefstroom Electronic Law Journal* (2010) 84, 88.

<sup>16</sup>Evans (note 14 above).

### 1.3 Rationale of the study

Over-indebtedness can cause a great deal of pain and hopelessness to those who are unable to pay their bills each month. A vast number of over-indebted debtors spend their lives earning money just to pay off their debts.<sup>17</sup> Families and individuals have suffered due to the instabilities associated with over-indebtedness.<sup>18</sup> For many, debt is like a social ill that never heals: it is a never ending cycle. It is often an insurmountable hurdle for over-indebted debtors to obtain a discharge.<sup>19</sup> There is, therefore, a need for the legislature to address this area of law.

This study, therefore, will be of importance to the economy and over-indebted debtors, of which there are many in South Africa. A recent newspaper article pointed out that ‘the credit market is volatile, most over-indebted low income workers turn to micro-lenders, who offer unsecured loans at hefty interest’.<sup>20</sup> These micro-lenders in turn make excessive use of garnishee orders to secure repayment of debts where credit was granted recklessly.

Staggering numbers of South Africans are going home at the end of the month with severely diminished salaries because of garnishee orders.<sup>21</sup> This is shown in a report by the University of Pretoria's Law Clinic which revealed that ‘more than 500,000 South Africans have their salaries docked every month’.<sup>22</sup> This, therefore, calls for the legislature to come to the rescue of LILA debtors. Further, much of the labour strife is a result of the economic meltdown due to debts not discharged, as shown by the incident at Marikana (where miners went on strike and there was massive shooting by the police), a town with minimal infrastructure but eleven micro-lenders.<sup>23</sup> Debt trap situations in a country's economy, with debtors unable to repay their debts, can contribute to a large extent to an economic meltdown.<sup>24</sup> This may be attributed to the absence of effective debt relief measures providing for debtors such as LILA

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<sup>17</sup>T A Lefifi ‘Study shows defaulters cost economy R9, 7bn’ available at <http://www.bdlive.co.za/economy/2013/11/24/study-shows-defaulters-cost-economy-r9.7bn> accessed 26 November 2013.

<sup>18</sup>D Hall ‘New restructuring targets for banks don't go far enough to debt distressed borrowers’ available at <http://www.thejournal.ie/readme/column-new-restructuring-targets-for-banks-dont-go-far-enough-to-help-distressed-borrowers-830976-Mar2013/> accessed 18 November 2013.

<sup>19</sup>Lefifi (note 17 above).

<sup>20</sup>C Benjamin ‘Business garnishee abuse order of the day’ available at <http://mg.co.za/article/2013-10-25-00-garnishee-abuse-is-order-of-the-day> accessed 4 November 2013.

<sup>21</sup>S Mouton ‘Easy credit a cause of labour strife’ available at <http://www.timeslive.co.za/thetimes/2013/10/11/easy-credit-a-cause-of-labour-strife> accessed 26 October 2013.

<sup>22</sup>Lefifi (note 17 above).

<sup>23</sup>Benjamin (note 20 above).

<sup>24</sup>World Development Movement ‘Third world debt’ available at <http://www.wdm.org.uk/category/issues/third-world-debt> accessed 18 November 2013.

debtors. Measures will be recommended that benefit LILA debtors so that they will not be left in a situation where they are trapped by debt.

It is therefore imperative for the legislature to address this area of law as every consumer must at least be protected as envisaged by section 3(g) of the NCA. The section points out that one of the means to achieve the purpose of the Act is ‘...to provide mechanisms for resolving over-indebtedness’.<sup>25</sup> This has not been achieved thus far. Protection for certain categories of debtors such as the LILA has not been achieved by the NCA nor other debt relief legislation in South Africa. As such, presently, in South Africa there are no mechanisms for providing debt relief to most LILA debtors. A call may therefore be made for this area of law to be addressed.

#### **1.4 Focus of research**

This study will focus on the position of LILA debtors within the context of the current debt relief mechanisms in South Africa. It will look at how select foreign jurisdictions have passed legislation to ameliorate the position of LILA debtors, in order to provide them with a measure of debt relief. Comparisons will then be made with a view to identifying potential appropriate reform for South African law.

#### **1.5 Conceptual Framework**

South African insolvency law favours the interests of creditors. This is evidenced by the ‘advantage to creditors’ requirement that must be met by debtors for their estates to be sequestrated and, ultimately, for them to be rehabilitated, with the accompanying discharge in respect of liability for pre-sequestration debt, as discussed above. The ‘advantage to creditors’ requirement is an insurmountable hurdle to a poor debtor who is then left only with the option of seeking debt relief under the NCA or MCA. However, debt review and re-arrangement and the administration order each target a particular group of debtors. Hence a debtor may find themselves in a situation whereby they have no debt relief mechanism at their disposal. The underlying assumption in this study is that a more favourable approach to debtors, or, more accurately, one which balances the interests of debtors and creditors, should be embraced.

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<sup>25</sup>S 3 (g) of the NCA.

## **1.6 Research questions and overviews of chapters**

In order to achieve the purpose stated above, this paper will endeavor to answer the following research questions:

1. What are the current debt relief measures in South Africa?
2. Do the current debt relief measures in South Africa appropriately provide debt relief to LILA debtors?
3. What gaps currently exist in South Africa debt relief measures as far as LILA debtors are concerned?
4. Which statutory provisions, with regard to LILA debtors, may be identified from other foreign jurisdictions as appropriate for adoption in South Africa?
5. What changes may be made in order to provide appropriate debt relief to LILA debtors in South Africa?

This, first chapter serves as an introduction to the dissertation. Debt relief measures in South Africa will be dealt with in the second chapter, which will discuss the common law compromise, voluntary surrender, compulsory sequestration, administration orders, and, finally, debt review and debt re-arrangement. Chapter Two will also briefly discuss past law reform initiatives, including proposed amendments contained in the Insolvency Bill.<sup>26</sup>

Chapter Three will compare debt relief measures in other jurisdictions, namely the USA, England and Wales, Scotland, Ireland and New Zealand. The debt relief mechanisms providing relief to LILA debtors in these foreign jurisdictions will be the area of focus. The final chapter will provide a conclusion and recommendations.

## **1.7 Research objectives and methodology**

The study aims to critically analyse the current debt relief mechanisms in South Africa and to show that they do not adequately provide debt relief to LILA debtors.

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<sup>26</sup>Insolvency Bill 2000.

It will demonstrate that some of the applicable debt relief mechanisms, such as the administration order<sup>27</sup> and debt review and debt re-arrangement,<sup>28</sup> by not allowing debt discharge, deprive a debtor from obtaining a ‘fresh start’.

The study will evaluate debt relief mechanisms in selected foreign jurisdictions which *do* grant a measure of debt relief to a LILA debtor. Ultimately, appropriate changes to the current debt relief measures will be proposed to ensure that a LILA debtor in South Africa has a measure of debt relief at his or her disposal.

The study is based solely on available legislation, reported judgments and published literature. Reference to South African legislation and regulations will inform an outline of the position in South Africa insolvency law, regarding the requirement for and circumstances in which a debtor may obtain discharge from liability to his or her creditors. A comparative study of the position in other jurisdictions, such as the USA, England and Wales, Scotland, Ireland and New Zealand will be undertaken. Reference will be made to legislative provisions applicable in these jurisdictions as well as the available literature.

I have endeavoured to state the position as at 1 December 2014.

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<sup>27</sup>A Boraine ‘The reform of administration orders within a new consumer credit framework’ in M Kelly-Louw et al *The future of consumer credit regulation creative approach to emerging challenges* Ashgate Publishing Ltd (2008) 187,190,194 and 196.

<sup>28</sup>C van Heerden and A Boraine ‘The interaction between the debt relief measures in the National Credit Act 34 of 2005 and aspects of insolvency law’ *Potchefstroom Electronic Law Journal* (2009) 22, 31.

## CHAPTER TWO: DEBT RELIEF MECHANISMS IN SOUTH AFRICA

‘Growth in consumer borrowing is across all sectors of societies but is relatively strong among low income households and sources of credit are most likely to be used when their incomes are disrupted for any reason. Financial difficulties however are not restricted to low income households, but can be found amongst all groups of consumers in our societies. Nor must it be suggested that consumer debtor insolvency is always credit related. There are many reasons a debtor becomes insolvent.’<sup>29</sup>

### 2.1 Introduction

As indicated in Chapter One, in South Africa, there are three statutory debt relief measures which apply in relation to personal, or consumer, insolvency and over-indebtedness. The common law also allows a debtor to reach a compromise with his or her debtors. This lies outside of the ambit of these statutory measures. This chapter deals with the various debt relief processes in South Africa, including substantive and procedural requirements. First, the common law compromise will be outlined, followed by sequestration in terms of the Insolvency Act 24 of 1936, administration in terms of the Magistrates’ Courts Act 32 of 1944 and, finally, the debt review procedure in terms of the National Credit Act 34 of 2005. Consideration will be given to whether each of these debt relief mechanisms is sufficient to assist a LILA debtor who is in financial distress. This will be done with a view to ascertaining whether any legislative reform is necessary in South Africa.

### 2.2 The common law compromise

The common law allows for a compromise to be reached between a debtor and his or her creditor(s).<sup>30</sup> A compromise may or may not lead to full settlement of the obligations, depending on the terms of the agreement between the parties.<sup>31</sup>

In practice, it is unlikely that a LILA debtor would resort to compromise as a debt relief mechanism. The lack of assets and income would negatively affect a LILA debtor’s bargaining power or capacity to make any reasonable offer of a feasible compromise. Very few creditors would be likely to agree to the sort of risky compromise that would be offered

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<sup>29</sup>INSOL International *Consumer Debt Report* 2001 1.

<sup>30</sup>R H Christie and GB Bradfield *Christie’s The law of contract in South Africa* 6 ed Lexis Nexis Butterworths (2011) 473.

<sup>31</sup>Ibid 473ff.

by such a debtor.<sup>32</sup> In any event, ordinarily, it would only be a legally qualified practitioner, or a person versed in commercial practice who would propose to creditors' possible terms for a compromise. From a practical perspective, a LILA debtor's limited resources would make access to legal representation or the enlistment of the aid of such a commercially savvy representative unlikely.

## 2.3 Sequestration in terms of the Insolvency Act

### 2.3.1 Background

The Insolvency Act provides for the sequestration of a debtor's estate. Sequestration requires an application to be brought in the High Court and, if the sequestration order is granted, the effect is, *inter alia*, that all civil proceedings are stayed, the assets of the insolvent debtor vest in the Master of the High Court and, once appointed, in the trustee of the insolvent estate. Sequestration forms a *concursum creditorum*, a gathering of creditors, who lodge claims against the estate, and the estate assets are liquidated and the proceeds distributed to creditors in accordance with the provisions of the Insolvency Act.<sup>33</sup> This mechanism can be said to be in line with the late Meskin's<sup>34</sup> view that if a system does not provide debt relief to an honest and unfortunate debtor it is therefore promoting loan sharks and their enforcers.

There are two ways in which a debtor's estate may be sequestered: voluntary surrender and compulsory sequestration. As its name suggests, the voluntary surrender procedure is initiated by the debtor himself or herself, while compulsory sequestration requires a creditor to apply for the sequestration of the debtor's estate, citing the debtor as respondent. In what has come to be known as a 'friendly sequestration', it is also common practice for a debtor to arrange with a creditor, or someone who pretends to be a creditor, to apply for the compulsory sequestration of the former's estate. This has led to abuse of the court process and malpractice.

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<sup>32</sup>A Boraine and M Roestoff 'The treatment of insolvency of natural persons in South African law – An appeal for a balanced and integrated approach' in Hassane Cisse *Fostering development through opportunity, inclusion and equity The World Bank Legal Review*, Volume 5 (2014) 105. See also *World Bank Report* (note 6 above) par 133.

<sup>33</sup>E Bertelsmann et al *Mars The law of insolvency in South Africa* 9 ed Juta and Co Ltd (2008) 2-3. See also *Richter v Riverside Estates (Pty) Ltd* 1946 OPD 209 223, *Walker v Syfret NO* 1911 AD 141 160.

<sup>34</sup>P Meskin 'Advantage to creditors: A misconceived requirement' paper delivered at Annual Banking Law Update at Rand Afrikaans University (1995).

Both voluntary surrender and compulsory sequestration applications are instituted by way of an application to the High Court.<sup>35</sup> This makes the sequestration process expensive. Although it is theoretically possible to represent oneself in the High Court, in practice, this is not feasible and thus sequestration would entail the cost of engaging representation by an attorney and an advocate, which further increases the cost of sequestration. Voluntary surrender and compulsory sequestration will be discussed below.

### **2.3.2 Voluntary surrender**

#### **i) Requirements**

Section 3 of the Act provides that an individual debtor or his agent may apply to the court for the acceptance of the surrender of his or her estate. Spouses married in community of property must both apply for the voluntary surrender of their joint estate.<sup>36</sup> Before a court may make a sequestration order, it must be satisfied that:<sup>37</sup>

- the formalities requirements contained in section 4 of the Insolvency Act have been complied with;
- the debtor is insolvent;<sup>38</sup>
- the debtor owns realisable property sufficient to defray all costs of sequestration, which will be payable out of the ‘free residue’<sup>39</sup> of the estate; and
- sequestration will be to the advantage of creditors.

#### **a) Preliminary formalities**

Preliminary formalities required by section 4 of the Insolvency Act include publication of a notice of surrender,<sup>40</sup> in the Government Gazette and in a newspaper circulating where the debtor resides or, if he is a trader, where the business is situated. The notice must be published not more than thirty days and not less than fourteen days of the advertised application date.<sup>41</sup> The purpose of the notice is to give creditors ample time and opportunity to oppose the intended application if they wish to do so. Further, within a period of seven

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<sup>35</sup>S 149 (1) of the Act sets out which court has jurisdiction; the position is also regulated by Rule 6 of the HC Rules.

<sup>36</sup>S 17(4) of the Matrimonial Property Act 88 of 1984.

<sup>37</sup>S 6 (1) of the Insolvency Act.

<sup>38</sup>The test for insolvency is whether the debtor’s liabilities, fairly estimated, exceed his assets, fairly valued; see *Ex parte Harmse* 2005 1 SA 323 (N) 325; *Venter v Volkskas Ltd* 1973 3 SA 175 (T) 179.

<sup>39</sup>‘Free residue’ is defined in s 2 of the Insolvency Act; it is the unencumbered portion of the estate assets.

<sup>40</sup>This must comply with Form A in the First Schedule to the Insolvency Act.

<sup>41</sup>S 4 (1) of the Insolvency Act.

days from the date of the publication of the said notice in the Gazette, the applicant must deliver or send by registered post a copy of the notice to each creditor.<sup>42</sup> In cases where the applicant is an employer, he or she is also required to deliver a copy to a registered trade union which is representative of employees as well as to employees.<sup>43</sup> The applicant must also deliver a copy to the South African Revenue Service.<sup>44</sup> The effect of the publication of the notice to surrender is that a moratorium is placed upon the sale in execution of any property in the estate.<sup>45</sup>

In terms of section 4 of the Insolvency Act, a debtor also has to lodge with the Master of the High Court a statement of affairs that conforms to the prescribed Form B in the First Schedule to the Act. Creditors are given an opportunity to inspect the statement of affairs which is required to lie open at the Master's Office or local magistrate's court for not less than fourteen days. The application for voluntary surrender, with proof of compliance with preliminary formalities, must be filed with the Registrar of the High Court, and, where applicable, copies must be delivered to a 'consulting party'<sup>46</sup> in accordance with section 197B of the Labour Relations Act<sup>47</sup> (LRA), in case there will be dismissals of employees of the insolvent debtor based on operational requirements.

## **b) Advantage to creditors**

'Advantage to creditors' is a theme that runs throughout the Insolvency Act.<sup>48</sup> In voluntary surrender, the burden upon the applicant to prove 'advantage to creditors' is onerous: he or she must *satisfy* the court that sequestration *will* be to the advantage of creditors. The reason for this, as stated by Hathorn JP, in *Amod v Khan*,<sup>49</sup> is that 'a debtor knows all about his own affairs and can easily prove the advantage to creditors'. 'Creditors', in this context, means the general body of creditors.<sup>50</sup> 'Advantage' means a pecuniary advantage or benefit and it has

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<sup>42</sup>S 4 (2) of the Act. Non-compliance with the set procedure has repercussions, although courts may condone it in appropriate circumstances; *Ex parte Harmse* (note 38 above) 331.

<sup>43</sup>S 4 (2) (b) (i) and (ii) of the Act.

<sup>44</sup>S 4 (2) (b) (iii) of the Act.

<sup>45</sup>S 5 of the Act.

<sup>46</sup>As contemplated by s 189(1) of the Labour Relations Act 66 of 1995.

<sup>47</sup>LRA 66 of 1995.

<sup>48</sup>C H Smith 'The recurrent motif of the Insolvency Act – Advantage for creditors' 7 *Modern Business law* (1985) 27. Smith points out that the phrase 'advantage to creditors' is found in many sections of the Act including other sections which point to advantage to creditors in an indirect way, such as ss13(1), 19,21, 23, 26, 29, 30, 5, 119 and 15.

<sup>49</sup>1947 2 SA 432 N 438.

<sup>50</sup>*Peycke v Nathoo* (1929) 50 NLR 178 185. This case is referred to by R G Evans 'Friendly sequestrations, the abuse of the process of court and possible solutions for overburdened debtors' 13 *SA Merc L J* (2001) 485,488. See also *Lotzof v Raubenheimer* 1959 1 SA 90 (O) 94; *Stainer v Estate Bukes* 1933 OPD 86.

been held that, for sequestration to be to the advantage of creditors, it should yield a greater return for creditors than the ordinary execution process would. It has also been held to mean that creditors will receive a ‘non-negligible dividend’.<sup>51</sup> The Insolvency Act is silent on what would constitute a dividend that would be advantageous to creditors. Each case is decided on its own merits. In *Ex parte Ogunlaga*,<sup>52</sup> for instance, it was held by North Gauteng High Court that the dividend must at least be 20 cents in the rand. The requirement of ‘advantage to creditors’ will be discussed further in relation to compulsory sequestration, below.<sup>53</sup>

### **c) Court’s discretion**

A court may, before accepting or declining the surrender, direct the petitioner or any other person to appear and be examined before the court.<sup>54</sup> The court has the discretion to refuse to grant the sequestration order even though the requirements have been met.<sup>55</sup> Instances where a court is likely to exercise its discretion not to accept the application are, for example, where:<sup>56</sup>

- the application has been opposed by the creditors, who are willing to afford the applicant time to meet his or her obligations;
- there was an ulterior motive for bringing the application;
- there has not been full disclosure of the applicant’s financial position; and it deems application of the National Credit Act’s machinery as being more appropriate than sequestration.

All of these could potentially be applicable in a voluntary surrender by a LILA debtor, who, if he or she is able to access funds sufficient for a High Court application, could in all likelihood have brought the application solely to avoid having to continue paying burdensome debts. In *Ex parte Ford*,<sup>57</sup> a case in which the applicant debtors might be described as having few assets and little or no income, the court declined to grant the application for voluntary surrender. This is because the court was of the view that the mechanisms provided by the National Credit Act offered a more appropriate solution for not

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<sup>51</sup>*Ex Parte Smith* 1958 3 SA 568 (O) 371; *Trust Wholesalers and Woollens (Pty) Ltd v Mackan* 1954 2 SA 109 (N) 111; *Meskin and Co v Friedman* 1948 2 SA 555 (W) 559; *London Estates (Pty) Ltd v Nair* 1957 3 SA 591 (D) 593.

<sup>52</sup>2011 JOL 27029 (GNP). This case is referred to by Boraine and Roestoff (note 32 above) 94.

<sup>53</sup>See 2.3.3.i) below.

<sup>54</sup>S 3 (3) of the Act.

<sup>55</sup>*Ex parte Hayes* 1970 4 SA 94 (NC) 96.

<sup>56</sup>R Sharrock et al *Hockly’s Insolvency Law* 9 ed Juta and Co Ltd (2012) 30.

<sup>57</sup>2009 3 SA 376 (WCC). The National Credit Act is discussed at 2.5 below.

only the applicant debtors, but also their ‘responsible’ creditors. The court thus gave preference to the public policy reflected in the NCA, which requires full satisfaction of all responsible financial obligations by the consumer.<sup>58</sup> The court reached its decision regardless of the fact that debt repayment plans were not financially feasible for the applicants.

### 2.3.3 Compulsory sequestration

#### i) Requirements

A sequestrating creditor has to approach the court twice in order to obtain, first, a provisional order,<sup>59</sup> and then, a return day having been set for the debtor (the respondent) to show cause why the order should not be made final,<sup>60</sup> again, in order for the provisional order to be confirmed.<sup>61</sup> For the court to grant a sequestration order:

- the applicant creditor must have established a liquidated claim against the debtor of not less than R100;<sup>62</sup>
- the debtor must have committed an act of insolvency as envisaged in section 8 of the Act or be insolvent;<sup>63</sup> and
- there must be reason to believe that sequestration will be to the advantage of creditors.<sup>64</sup>

For a court to make a provisional sequestration order, it must be of the opinion that *prima facie* the above *facta probanda* have been established and, for a final order, it must be satisfied they have been established.<sup>65</sup> If the court is not so satisfied, it is obliged to dismiss the application for compulsory sequestration and discharge the provisional order.<sup>66</sup> Before the application may be heard, the creditor has to furnish security for costs including the fees and charges necessary for the finalisation of the sequestration proceedings and of all costs of administering the estate until a trustee has been appointed, or, if no trustee is appointed, of all

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<sup>58</sup>*Ex parte Ford* (note 57 above) par 20.

<sup>59</sup>S 10 of the Act.

<sup>60</sup>This is in terms of s 11 of the Act.

<sup>61</sup>S 12 of the Act.

<sup>62</sup>Subss 9(1) and 9(3) of the Act. (Alternatively, two or more creditors must have claims of not less than R200 in aggregate.) See *Meyer v Batten* 1999 1 SA 1041 (W).

<sup>63</sup>S 9(1) of the Act.

<sup>64</sup>S 10 (c) and s 12(1) (c) of the Act. This is discussed by M Roestoff et al ‘The debt counseling process – closing the loopholes in the National Credit Act 34 of 2005’ *Potchefstroom Electronic Law Journal* (2009) 12, 4.

<sup>65</sup>Compare ss 10 and 12 of the Act.

<sup>66</sup>S 12(2) of the Act.

fees and charges necessary for discharge of the estate from sequestration.<sup>67</sup> The applicant creditor must furnish a copy of the application to the debtor<sup>68</sup> and also, where the debtor is an employer, to a registered trade union which represents any of the employees, and to employees, and also to the South African Revenue Service.<sup>69</sup>

The creditor may not be in a position to establish that the debtor's liabilities exceed his or her assets.<sup>70</sup> Therefore, the legislature has in section 8 of the Insolvency Act created eight different acts or omissions, referred to as 'acts of insolvency',<sup>71</sup> and proof of any one of these is sufficient for an order of sequestration to be granted.

The requirement of 'advantage to creditors' was discussed above, in relation to voluntary surrender.<sup>72</sup> However, whereas, for voluntary surrender, a court must be satisfied that sequestration will be to the advantage of creditors, the burden of proof is less onerous in compulsory sequestration where there must be 'reason to believe' that sequestration will be to the advantage of creditors. Further, also as mentioned above, the burden at the provisional order stage is lighter than at the later stage when the court is considering whether to grant a final order of sequestration.<sup>73</sup>

In relation to whether it has indeed been proved that there is reason to believe that sequestration will be to the advantage of creditors, it was held by Roper J in *Meskin and Co v Friedman*<sup>74</sup> that the facts before the court must satisfy it that, 'there is a reasonable prospect – not necessarily a likelihood, but a prospect which is not too remote – that some pecuniary benefit will result to the creditors'. It may be noted that, as mentioned above in relation to voluntary surrender, the legislature has not laid down a minimum dividend for creditors to constitute 'advantage to creditors'. The North Gauteng High Court is guided by a dividend of 20c in the rand.<sup>75</sup> It may be noted that, for a court to find that there is 'reason to believe' that sequestration will be to the advantage of creditors, it is not imperative for the applicant to prove that the debtor has assets, but it is sufficient if it is shown that there is a reasonable

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<sup>67</sup>S 9 (3) of the Act.

<sup>68</sup>S 9 (4A) (a) (iv). Failure to do so may be condoned where appropriate: see *Fisher v Pujol* 1972 2 SA 496 (T), Rule 6 (2) read with Rule 6 (5) (a) of the Uniform Rules of Court.

<sup>69</sup>S 9 (4A) (a) (i) - (iii) of the Act. See also *Standard Bank of South Africa v Sewpersadh* 2005 4 SA 148 (C).

<sup>70</sup>See *De Villiers NO v Maursen Properties (Pty) Ltd* 1983 4 SA 670 (T) 676.

<sup>71</sup>S 8 (a) - (h).

<sup>72</sup>See 2.3.2.i),b) above.

<sup>73</sup>*Trust Wholesalers and Woollens (Pty) Ltd* (note 51 above) 113.

<sup>74</sup>*Meskin and Co* (note 51 above).

<sup>75</sup>It may be noted that some courts have been reluctant to set a dividend on the basis that this would be encroaching upon the duties of the legislature; see, for instance, *Hillhouse v Stott* 1990 4 SA 580 (W) 586.

prospect that substantial assets will result after proper investigation following a sequestration order.<sup>76</sup>

## ii) Friendly sequestration

Due to the stringent requirement, for voluntary surrender, of proving that sequestration will be to the ‘advantage to creditors’, as well as the need for complying with the preliminary formalities required by section 4 of the Insolvency Act, debtors commonly resort to getting a person to bring an application for the compulsory sequestration of his or her estate. This has come to be known as ‘friendly sequestration’. Very often, a debtor will simply write to his or her creditor, stating that he or she is unable to pay the debt. This will then constitute the act of insolvency under section 8 (g) of the Act on which the applicant will rely. The main object of this process being to assist the debtor, courts must scrutinise these cases in order to ascertain that an ‘advantage to creditors’ will result if the debtor’s estate is sequestrated.<sup>77</sup> In practice, friendly sequestration commonly constitutes an abuse of the court process in that often an applicant will pose as a creditor in circumstances where there is no debt owing to him or her, ie, the claim is fictitious, or the value of assets is falsely inflated or the debts are underestimated in order to create the impression that there will be an advantage to creditors. In this regard, in *R v Meer and others*,<sup>78</sup> Holmes J stated that:

‘the court could guard against such abuse in two ways: firstly, by paying more regard to the element of advantage to creditors in the petition, especially in cases which savour of friendly sequestrations under section 8 (g); secondly, by refusing to grant repeated adjournments of the rule nisi unless satisfied, on affidavit, that such would be to the advantage of creditors.’

In *Nell v Lubbe*<sup>79</sup> it was stated by Levenson J that:

‘the purpose of furnishing a sworn valuation is therefore to establish the price that is likely to be realized from the sale of the property on what is called a forced sale so that it can be determined that there will be a free residue available for creditors and the advantage to creditors is thereby established.’

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<sup>76</sup>*Meskin and Co* (note 51 above); *Lynn & Main Inc v Naidoo and Another* 2006 1 SA 59 (N).

<sup>77</sup>*Epstein v Epstein* 1987 4 SA 606 (C); *Klemrock (Pty) Ltd v De Klerk* 1973 3 SA 925 (W). See also Evans (note 50 above) 487.

<sup>78</sup>1957 3 SA 614 (4).

<sup>79</sup>1999 3 SA 109 (W) at 111D.

### 2.3.4 Effects of sequestration

As mentioned above,<sup>80</sup> as soon as the sequestration order is granted, civil proceedings against the debtor are stayed and the assets of the insolvent debtor vest in the Master of the High Court and, once appointed, in the trustee of the insolvent estate. Certain assets are either exempted or excluded from the insolvent estate. For example, section 82(6) of the Insolvency Act allows an insolvent to retain, and for the exception from sale, clothing, bedding, household furniture and tools and other essential means of subsistence. Further, section 23 of the Insolvency Act provides that the insolvent will be entitled to wages and earnings after sequestration, subject to the trustee claiming any excess that is not needed by the insolvent and his family for subsistence,<sup>81</sup> pension monies acquired before and after sequestration,<sup>82</sup> and compensation for loss for personal injury or defamation suffered before or after sequestration.<sup>83</sup> The insolvent is also entitled to retain certain life insurance policies over own life.<sup>84</sup> The purpose of these provisions is to allow the insolvent and his dependants basic necessities so that they do not become a burden on the state and society and also to encourage the insolvent to become a productive member of society. Creditors must lodge claims against the estate, which is administered by the trustee. The trustee's duty is, inter alia, to liquidate estate assets and, after sequestration and administration costs have been met out of the proceeds, to distribute the balance to creditors in accordance with the provisions of the Insolvency Act.<sup>85</sup>

### 2.3.5 Rehabilitation

An insolvent debtor may, on six weeks' notice to the Master and after placing a notice of his or her intention in the government gazette,<sup>86</sup> bring an *ex parte* application in the high court for an order for his or her rehabilitation. Different time periods apply, within which an insolvent may seek rehabilitation, depending on the circumstances.

Section 124 (3) of the Insolvency Act permits an insolvent to apply for rehabilitation after six months from the date of sequestration if no claims are proved against his or her estate. Section 124 (2) permits an insolvent to apply for rehabilitation once twelve months have

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<sup>80</sup>See 2.3.1 above.

<sup>81</sup>See s 23(9) read with s 23(5).

<sup>82</sup>See s 23(7).

<sup>83</sup>See s 23(8).

<sup>84</sup>See s 63 (1) (a) and s 64 (b) of the Long-term Insurance Act 52 of 1998.

<sup>85</sup>S 91 of the Act. See also Sharrock et al (note 56 above) 130.

<sup>86</sup>S 124 (3) (a) of the Act.

elapsed since the confirmation by the Master of the first trustee's estate account, unless the insolvent's estate has been sequestrated before, in which case he or she must wait for three years before making application for rehabilitation. Where an insolvent has been convicted of a fraudulent act in relation to this or a previous insolvency, then he or she can apply for rehabilitation only after four years of the date of sequestration. In terms of section 124, the Master's positive recommendation is required in cases where an application is brought within four years of sequestration. It is in the court's discretion whether to grant or decline rehabilitation of the insolvent.<sup>87</sup> If an insolvent has not been rehabilitated by the court within a period of ten years from the date of his or her sequestration, he or she shall be deemed to be rehabilitated after the expiry of such period as long as no application has been made by an interested party *not* to rehabilitate the insolvent.<sup>88</sup> Rehabilitation of an insolvent brings the sequestration process, and the debtor's insolvent status, to an end. Rehabilitation discharges the insolvent from liability for pre-sequestration debts and relieves him or her of all disabilities and restrictions resulting from sequestration.<sup>89</sup> Thus an insolvent is able to obtain a 'fresh start'. This position is in line with the *World Bank Report* where it is stated that 'one of the principal purposes of the insolvency system for natural persons is to re-establish the debtor's economic capability, in other words, *economic rehabilitation*'.<sup>90</sup>

### 2.3.6 LILA debtors and sequestration

Given a LILA debtor's position, with low income and minimal assets, even if he or she is able to afford the costs associated with a High Court application, it is unlikely that he or she would be able to satisfy the court that sequestration will be to the 'advantage to creditors', in a voluntary surrender, or that his or her creditor would meet the burden imposed on it to show that there is reason to believe that compulsory sequestration, albeit a friendly one, would yield sufficient advantage to the general body of creditors. Therefore, it is submitted that sequestration, and consequent rehabilitation, would not be accessible to a LILA debtor as a debt relief option.

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<sup>87</sup>S 127 (2) of the Act.

<sup>88</sup>S 127 (A) (1) of the Act.

<sup>89</sup>S 129 (1) (a) - (c) of the Act.

<sup>90</sup>*World Bank Report* (note 6 above) par 359.

## 2.4 Administration under the Magistrates' Courts Act

### 2.4.1 Background

Section 74 of the MCA provides for the magistrate's court to make an order for the administration of a debtor's estate. As Boraine<sup>91</sup> explains, it is a debt relief mechanism by means of which debtors who find themselves in 'a financial predicament ... [are given] a chance to obtain a statutory rescheduling of debt sanctioned by an order of the court'. As stated in *Madari v Cassim*,<sup>92</sup> an administration order is 'a modified form of insolvency available to small estates whereby a *concursum creditorum* is created easily and cost effectively allowing for a court-sanctioned debt arrangement'.<sup>93</sup>

### 2.4.2 Requirements

An administration order may be granted only in respect of a debtor whose total debt does not exceed R50 000.<sup>94</sup> Upon application by a debtor, who is unable to pay any amount of any judgment debt obtained against him or her or to meet his or her financial obligations and has insufficient assets capable of attachment to satisfy such judgment or to meet his or her obligations, the magistrate's court, where the debtor resides, carries on business or is employed,<sup>95</sup> may grant an order for the administration of his or her estate.<sup>96</sup>

The order may also be granted by the court under section 65I of the MCA.<sup>97</sup> The court may make the order subject to conditions that it may deem fit with regard to security, preservation or disposal of assets, and realisation of movables subject to a hypothec. The administration order enjoys preference over a section 65 inquiry<sup>98</sup> and therefore the court will put the inquiry on hold until the administration order is discharged.

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<sup>91</sup>A Boraine 'Some thoughts on the reform of administration orders and related issues' *De Jure* (2003) 217, 217-218; See also discussion in L Steyn 'Statutory regulation of forced sale of the home in South Africa' (2012) LLD thesis University of Pretoria 142 available at <http://upetd.up.ac.za/thesis/available/etd-10022012-144930/> accessed on 7 July 2014.

<sup>92</sup>1950 2 SA 35 (D).

<sup>93</sup>Ibid par 38. See also *Weiner v Broekhuysen* 2003 4 SA 301 (SCA) at 305E-F, Jones and Buckle *The Civil Procedure Practice of the Magistrates' Courts in South Africa* 9 ed (1997) 305.

<sup>94</sup>S 74(1) (b) read with GN 1441, *Government Gazette* 19435 of 30 October 1998, with effect from 1 November 1998.

<sup>95</sup>S 74 (1) of the MCA.

<sup>96</sup>Ibid.

<sup>97</sup>Ibid.

<sup>98</sup>S 65 I (1) of the MCA.

The debtor must lodge with the clerk of the court a statement of affairs<sup>99</sup> the correctness of which must be confirmed by an affidavit made on oath.<sup>100</sup> An illiterate debtor must be assisted by the clerk of the court to complete a statement of affairs.<sup>101</sup> However, as pointed out by Malanje,<sup>102</sup> ‘in practice it is normal for an attorney to assist a consumer in preparing the application’. Further, the debtor is required to deliver to his or her creditors, at least three calendar days prior to the date appointed for hearing, personally or by registered post, a copy of the application for the administration order and a statement of affairs with a court case number.<sup>103</sup>

### **2.4.3 The hearing of the application**

The hearing of the application is open to any creditor, whether he or she received the section 74A (5) notice or not, who may object to any of the listed debts.<sup>104</sup> Further, the court or any creditor or the creditor’s legal representative may interrogate the debtor with regard to his assets and liabilities, his present and future income and that of his wife living with him, his standard of living and the possibility of economising and any other matter that the court may deem relevant.<sup>105</sup> The purpose of the enquiry is to establish how much a debtor can afford to pay weekly or monthly to the administrator. Section 74B (2) to (5) further sets out the steps that a court takes into consideration with regard to a debt in contention.

### **2.4.4 The administration order**

The administration order must be made in the prescribed form as determined by the magistrates’ courts rules.<sup>106</sup> The administration order must lay down weekly or monthly payments,<sup>107</sup> in the calculation of which the court must consider the debtor’s and dependents’ necessary expenses, certain prescribed periodical payments which the consumer is obliged to

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<sup>99</sup>S 74 (1) read with section 74A (1) and 5 of the MCA.

<sup>100</sup>S 74 A (3) of the MCA.

<sup>101</sup>S 74 A (4) of the MCA.

<sup>102</sup>N J Malanje ‘The impact of administration orders as a redress mechanism for over-indebted consumers: a critical analysis’ in Nejd et al *Globalizing businesses for the next century: visualizing and developing contemporary approaches to harness future opportunities* (2013) 626.

<sup>103</sup>S 74 A (5) of the MCA.

<sup>104</sup>S 74 B (1) (a) of the MCA.

<sup>105</sup>S 74B (1) (e) of the MCA.

<sup>106</sup>S 74 C (1) (a) of the MCA.

<sup>107</sup>Ibid.

make and other payments to be paid in future, such as payments under the administration order.<sup>108</sup>

When the court makes the administration order, it will appoint an administrator.<sup>109</sup> The debtor will be obliged regularly to pay the administrator,<sup>110</sup> who, after deducting a fee, will distribute payments to creditors.<sup>111</sup> The fee is regarded as being an added burden for a debtor.<sup>112</sup> In addition, despite the fact that a debtor makes regular payments to the administrator, the fees payable to the administrator reduces the amount creditors receive.<sup>113</sup> There are no set qualifications for a person to be an administrator and therefore anyone may apply to be one.

The court will authorise the issue of either an emoluments attachment order in terms of section 65J of the MCA, to attach emoluments at present owing or in future accruing to the debtor by or from his or her employer, or a garnishee order under section 72 of the MCA for attaching any debt owing or accruing to the debtor by or from any person (excluding the state). However, a court has the power to suspend such authorisation where it deems this just and reasonable.

#### **2.4.5 Effect of administration order**

The administration order suspends proceedings that have been, and from being, instituted against the debtor or his or her property, although costs that have already been incurred by a creditor may be added by the court to the judgment debt. Individual debt enforcement is barred since creditors will receive payment of their debt through distributions made by an administrator.<sup>114</sup> However, the court may grant leave to the creditor(s) for the enforcement of an objected debt in terms of section 74B (3) of the MCA and for the enforcement of a mortgage bond.<sup>115</sup> On the other hand, in terms of section 74R of the MCA, an administration order does not preclude sequestration of the debtor's estate.

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<sup>108</sup>S 74 C (1), (2) and (3) of the MCA.

<sup>109</sup>S 74 E (1) of the MCA. S 74 E (3) - (4) of the MCA sets out instances where an appointed administrator may or may not be required to furnish security.

<sup>110</sup>S 74C (2) of the MCA.

<sup>111</sup>S 74L of the MCA.

<sup>112</sup>M A Greig 'Administration orders as shark nets' 117 *South African Law Journal* (2000) 622, 626.

<sup>113</sup>M Kelly-Louw 'Prevention of over-indebtedness and mechanisms for resolving over-indebtedness of South African consumers' in J Niemi, I Ramsay & WC Whitford (ed) *Consumer Credit, Debt and Bankruptcy Comparative and International Perspectives* (2009) 193.

<sup>114</sup>S 74P (1) - (2) of the MCA.

<sup>115</sup>S 74P (1) of the MCA.

A debtor commits an offence by incurring other debts while under administration without disclosing that he or she is under administration.<sup>116</sup> The court may amend the amount of any installment payable by the debtor in terms of the administration order<sup>117</sup> and may amend an emoluments attachment order or a garnishee order to ensure the smooth flow of payments under the administration order. The court may also set either of the latter aside.<sup>118</sup>

In terms of section 74U of the MCA, an administration order will lapse, or be discharged, only once the debtor has paid in full all debts that are subject to it as well as interest and other costs. The position therefore differs from sequestration, where a dividend is paid to creditors and, upon rehabilitation; the debtor is discharged from all unpaid pre-sequestration debt. Once all debts and interest and costs have been paid, the administrator must submit a certificate to this effect to the clerk of court. Creditors will also be issued with a copy of the certificate which was sent to the clerk of court.<sup>119</sup>

No maximum period for which the debtor will be under administration is set by section 74. In this respect the position differs from that where the debtor's estate is sequestrated. It is therefore possible that a debtor may remain in a situation of 'debt servitude' for an extended period,<sup>120</sup> as occurs in many cases. This, coupled with interest charges, which will increase the debt, results in many debtors defaulting thus rendering the administration order ineffective.

As mentioned above, an administration order may be granted only where the debtor's total debt does not exceed R 50 000. This procedure therefore potentially gives debt relief only to a certain category of debtor. Malanje<sup>121</sup> submits that, 'if the monetary cap was higher it could also have included those who are currently excluded from the relief offered by rehabilitation following sequestration since they cannot prove an 'advantage to creditors' as required by the Insolvency Act'.

It is important to note that an administration order does not include *in futuro* debts. These are specifically excluded by sections 74 (1) and 74A (2) (e) of the MCA. However, this phrase is not defined in the MCA and it is not clear what would constitute an *in futuro* debt. It was held

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<sup>116</sup>S 74 S of the MCA.

<sup>117</sup>S 74 Q (3) (b) of the MCA.

<sup>118</sup>Ibid.

<sup>119</sup>S 74U.

<sup>120</sup>A Boraine and M Roestoff 'Revisiting the state of consumer insolvency in South Africa after twenty years: The courts' approach, international guidelines and an appeal for urgent law reform' (Part 1) 77 *THRHR* (2014) 351,354 and 358.

<sup>121</sup>Malanje (note 102 above) 629.

by Corbett J<sup>122</sup> that ‘the word “debts” in the proviso to s 74 of the Magistrates’ Courts Act means debts which are due and payable and does not include obligations to pay money *in futuro*’. It would appear therefore that instalments payable under credit agreements would not be included in the administration order and, if this is indeed the position, it has serious repercussions for the debtor. Boraine<sup>123</sup> submits that ‘*in futuro* debts will not be affected by the administration order, and the debtor thus still has to service such debts over and above the payments made to the administrator’. Greig<sup>124</sup> pointed out that, ‘...the success of an administration order is put seriously at risk where the order cannot include reductions of *in futuro* instalments’. Greig<sup>125</sup> further submits that ‘...the procedure discriminates irrationally between debts the “whole amount of which is owing” or which are due and payable and debts in terms of existing and microloan agreement, repayable in instalments, which have not been breached by the debtor’. It is submitted that it is these very *in futuro* debts which, because they are excluded from the administration order, are likely to lead the debtor, who is under administration, to default.

There has been on-going abuse of the administrative process. This contention is supported by Boraine<sup>126</sup> who submitted that ‘... many individuals who were under administration orders relied heavily on the so-called micro-lenders in ways that aggravate their debt situations rather than afford debt relief’. This is one of the reasons which led to proposals for reform of the administration order,<sup>127</sup> which will be discussed below.<sup>128</sup> A recent media article alleges abuse of the administrative process by a law firm in KwaZulu-Natal.<sup>129</sup> The firm has agents who search for debtors who are in desperate need of debt relief; they ‘...prepare necessary paperwork and facilitate the process of these individuals to seamlessly move through the legal system to be placed under administration’.<sup>130</sup> In return these agents are paid for their services to Booyen and Co. The firm in this respect is alleged to be abusing the

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<sup>122</sup>*Cape Town Municipality v Dunne* 1963 1 SA 741 (C) at 745A - B.

<sup>123</sup>Boraine (note 27 above) 191.

<sup>124</sup>Greig (note 112 above) 625.

<sup>125</sup>*Ibid* 626.

<sup>126</sup>Boraine (note 27 above) 188.

<sup>127</sup>*Ibid*. See Boraine’s discussion of the abuse of the process. See also, for example, *Weiner NO v Broekhuysen* (173/2001) [2002] ZASCA 162; [2002] 4 All SA 96 (SCA) (31 May 2002). In this case Weiner was charging fees in excess of 12.5 percent prescribed by section 74L (2) on payments collected from a couple who were in dire financial straits.

<sup>128</sup>See 2.6.3 below.

<sup>129</sup>T Beamish ‘KZN law firm’s massive administration order scheme’ available at <http://www.moneyweb.co.za/moneyweb-special-investigations/kzn-law-firms-massive-administration-order-scheme> accessed 25 November 2014.

<sup>130</sup>*Ibid*.

administrative process as well as breaking rules against touting.<sup>131</sup> The media article reports that ‘information in Moneywebs [agent of Booysen and Co] suggests that Booysen had 70 000 administration order clients on his books which flowed from various agents around the country, especially in KZN’.<sup>132</sup> However, Booysen denied the allegations but confirmed that it had less than 20 000 administration orders.<sup>133</sup>

#### **2.4.6 LILA debtors and administration**

While, at first glance, administration under the MCA might seem appropriate for a LILA debtor. This is because the costs of this magistrate’s court procedure are lower than those involved in sequestration and because proof of ‘advantage to creditors’ is not a requirement. However, it is likely that, given that there is no restriction to the period of operation of an administration order, with minimal excess income to apply to the payment of instalments, a LILA debtor will be the most vulnerable category of debtor who will remain in a situation of ‘debt servitude’, if not for life, then for a lengthy period. Further, a LILA debtor would likely be most adversely affected, given the increased interest and other costs and fees payable as a result of the extension of the period over which much lower regular instalments would have to be paid. The lack of regulation of the administration order system and the abuse of the administration order procedure, especially by administrators charging excessive fees,<sup>134</sup> and as discussed above,<sup>135</sup> the abuse of the administration process by law firms taking advantage of debtors in dire need of debt relief and manipulation of the process for their own gain, it is submitted, have severely prejudiced debtors, including LILA debtors, who have subjected themselves to administration orders.

It is conceivable that a LILA debtor might have accumulated debt in excess of R50 000. If this is the case, the R50 000 total debt limit will preclude a LILA debtor from seeking relief of his or financial distress by applying for an administration order. The exclusion of *in futuro* debts from an administration order make this an inappropriate debt relief option for a LILA debtor as it is anticipated that such a debtor will have a large proportion of his or her debt arising out of credit agreements. It is submitted that the requirements that debts must be paid

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<sup>131</sup>Ibid. See also discussion on abuse of the administration orders by unscrupulous professionals in Boraine and Roestoff (note 120 above) 353.

<sup>132</sup>Beamish (note 129 above).

<sup>133</sup>Ibid.

<sup>134</sup>*Weiner NO* (note 127 above). In this case Weiner was charging fees in excess of 12.5 percent prescribed by section 74L (2) on payments collected from a couple who were in dire financial straits.

<sup>135</sup>See (note 129 above).

in full, together with interest and other costs, poses the greatest obstacle to an administration order as a viable debt solution for a LILA debtor.

## **2.5 Debt review and debt rearrangement in terms of the National Credit Act**

### **2.5.1 Background**

The National Credit Act, which became fully operational in June 2007, was introduced with the purpose, *inter alia*, of providing a debt relief mechanism for debtors whose over-indebtedness arises from credit agreements. The debt review process provides for rearrangement of debt, allowing debtors to repay debts arising out of credit agreements over an extended period in terms of a court authorised plan. The NCA also makes provision for the setting aside of ‘reckless credit’ granted in instances where the creditor failed to conduct an assessment,<sup>136</sup> or where the assessment was carried out but the consumer did not understand and appreciate the risks, costs or obligations under the proposed credit agreement or entered into that agreement that would make him or her over-indebted.<sup>137</sup> One of the stated aims of the NCA is to promote responsibility in the credit market through introduction of measures to prevent over-indebtedness of consumers as well as the prevention of the reckless granting of credit.<sup>138</sup> The court, in *FirstRand Bank Ltd v Olivier*,<sup>139</sup> re-stated this purpose as being:

‘to provide for debt re-organization of a person who is over-indebted, thereby affording that person the opportunity to survive the immediate consequences of his financial distress and to achieve a manageable financial position.’

The mechanism provided by the NCA is applicable to provide relief to a consumer debtor who is a natural person, not a juristic person.<sup>140</sup> It applies in relation to pre-existing ‘credit agreements’.<sup>141</sup> The term ‘credit agreement’ is defined in the NCA.<sup>142</sup> In terms of the NCA, a debtor may apply to the magistrate’s court to be declared over-indebted and placed under debt review. It is also possible for any court hearing any matter in which an allegation of over-indebtedness is made, to refer the debtor to a debt counsellor.<sup>143</sup> This process will be discussed in more detail below. It may be noted that the NCA refers to the creditor as the

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<sup>136</sup>S 80 (1) (a) of the NCA.

<sup>137</sup>S 80 (b) of the NCA.

<sup>138</sup>S 3 (c) and (g) of the NCA.

<sup>139</sup>2009 3 SA 353 (SECLD) 357.

<sup>140</sup>S 78 (1) of the NCA.

<sup>141</sup>Item 4 (1) of schedule 3 of the NCA.

<sup>142</sup>S 8 of the NCA.

<sup>143</sup>S 85 (a) of the NCA.

‘credit provider’ and to the debtor as ‘the consumer’. In the course of this discussion, the creditor and the debtor will also be referred to, interchangeably, using the terms chosen by the legislature in the NCA, as may be appropriate.

### **2.5.2 Requirements and procedure**

According to section 79 of the NCA, a consumer is over-indebted if the available information shows that the consumer is or will be unable to discharge his or her obligations under the credit agreements in a timely manner, having regard to that consumer’s -

- (a) financial means, prospects and obligations; and
- (b) probable propensity to satisfy in a timely manner all obligations under the credit agreements.

In terms of section 85 of the NCA, in any court proceeding in which a credit agreement is being considered, if there is an allegation that the consumer is over-indebted, the court may-

- (a) refer the a matter to a debt counsellor for evaluation of the consumer’s circumstances and to make recommendations to the court in accordance to section 86 (7); or
- (b) declare that the consumer is over-indebted and make any order as contemplated in section 87 to relieve the consumer of his or her over-indebtedness.

Further, section 86 (1) of the NCA provides that a consumer may apply to a debt counsellor in the prescribed manner and form in order to be declared over-indebted. However, in terms of section 86 (2) of the NCA this may occur only in circumstances where the credit provider has not yet taken steps to enforce the credit agreement in terms of section 129 of the NCA. The debt counsellor may require the consumer to pay an application fee, which may not exceed the prescribed amount.<sup>144</sup> Currently, this amount is set at R50.<sup>145</sup> In terms of section 86(4) of the NCA, a debt counsellor must, upon receipt of an application by a consumer to be declared over-indebted:

- (a) provide the consumer with proof of receipt of the application;
- (b) notify, in the prescribed manner and form
  - (i) all credit providers that are listed in the application; and
  - (ii) every registered credit bureau.

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<sup>144</sup>S 86 (3) (a) of the NCA.

<sup>145</sup>Schedule 2 (2) of the NCA Regulations *Prescribed fees* available at <http://www.ncr.org.za/regulations/Schedule%202-prescribed%20fees.pdf> accessed on 25 November 2014.

A consumer must submit a completed form 16 to the debt counsellor in order to be declared over-indebted and should also provide all material information to the debt counsellor.<sup>146</sup> In order for the evaluation and debt-rearrangement to be successful, a consumer is expected to adhere to any requests made by the debt counsellor. The consumer must participate in good faith in the review and in any negotiations designed to result in responsible debt re-arrangement.<sup>147</sup>

A debt counsellor who has accepted an application by a consumer must within the prescribed time and manner determine whether he or she appears to be over-indebted.<sup>148</sup> Further, where a declaration for reckless credit is sought, the debt counsellor must determine whether the credit agreement appears to be reckless.<sup>149</sup> The debt counsellor will reject the application where it has been established that the consumer is not over-indebted.<sup>150</sup> This can take place despite the fact that the debt counsellor has reached a conclusion that a particular credit agreement is reckless.<sup>151</sup> On the other hand, where the debt counsellor reasonably concludes that the consumer *is* over-indebted, he or she may issue a proposal recommending that the magistrate's court makes an order, where appropriate, declaring one or more of the consumer's credit agreements to be reckless credit<sup>152</sup> and that one or more of the consumer's credit agreement obligations be re-arranged by: extending the period over which the price must be paid and reducing the amount of each payment due; and/or postponing during a specified period the dates on which payments are due under the credit agreement.<sup>153</sup>

In terms of sections 83(3) and 85 of the NCA, a court may declare a consumer to be over-indebted, may declare credit to be reckless, and may make any order re-arranging his or her obligations, in accordance with section 87, as mentioned above, in order to relieve such over-

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<sup>146</sup>Regulation 24 provides that a 'consumer who wishes to apply to a debt counsellor to be declared over-indebted must (a) submit to the debt counsellor a completed form 16; or (b) provide the debt counsellor with the following information: (i) personal details, including name, initials and surname and identity number, and, if the consumer does not have the identity number, passport number and date of birth, postal and physical address, and contact details; (ii) all income, inclusive of but not limited to: taxes, unemployment insurance fund, pension, medical aid, insurance, court orders and other ; (iii) monthly expenses, inclusive of, but not limited to: home loans, car finances and leases, securities signed and other living expenses, inclusive of, but not limited to: groceries, utility and continuous service, school fees, transport costs and other ; (vi) a declaration and undertaking to commit to the debt restructuring; (vi) a consent that a credit bureau check may be done; and (vii) confirmation that the information is true and correct.

<sup>147</sup>S 86 5 (b) of the NCA.

<sup>148</sup>S 86 (6) of the NCA. The prescribed time is eighteen months: See the NCA Regulations.

<sup>149</sup>S 86 (6) (b) read with regulation 24(8).

<sup>150</sup>S 86 (7) (a) of the NCA.

<sup>151</sup>Ibid.

<sup>152</sup>S 86(7) (c) (i) of the NCA.

<sup>153</sup>S 86(7) (c) (ii) of the NCA.

indebtedness. Before doing so, the court will consider whether the debtor is able to meet his or her current financial obligations<sup>154</sup> and also the expected date of full satisfaction by the consumer of his or her obligations under the credit agreement.<sup>155</sup> It does this on the assumption that a consumer will make full payment of all of his debts in accordance with the proposed court order.

Where a credit agreement is suspended, section 84(1) (c) imposes a moratorium against its enforcement. However, after suspension, the rights and obligations of the credit provider are revived and become fully enforceable, except where the court orders otherwise.<sup>156</sup>

A credit provider may give notice to terminate the review at any time after the lapse of 60 days since the date of application by the consumer for debt review.<sup>157</sup> It has been held that, for the credit provider to be entitled to do this, the consumer must be in default of the obligation(s) originally agreed upon.<sup>158</sup> Further, upon giving the requisite notice, the magistrate's court may make an order to resume the debt review on conditions that it considers just and reasonable.<sup>159</sup>

### **2.5.3 Effect of debt review, allegation of over-indebtedness or debt re-arrangement order**

A consumer who has filed an application for debt review with a debt counsellor, in terms of section 86 (1) of the NCA, or who has alleged in court that he or she is over-indebted, must not incur any further charges under a credit facility or enter into any further credit agreement (other than a consolidation agreement) with any credit provider until one of the following events has taken place:

- (a) the debt counsellor has rejected the application and the prescribed time period for direct filing in terms of section 86 (9) has expired without the consumer having so applied;
- (b) the court has determined that the consumer is not over-indebted, or has rejected a debt counsellor's proposal or the consumer's application; or

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<sup>154</sup>S 83 (4) (a) of the NCA.

<sup>155</sup>Ibid.

<sup>156</sup>S 84 (2) (a) (i) - (ii) of the NCA.

<sup>157</sup>S 86 (10) of the NCA.

<sup>158</sup>Ibid. See also, *Collet v FirstRand Bank Ltd* 2011 4 SA 508 (SCA) 516 par 12; *Mocwane and Another v Standard Bank of South Africa Limited and Another* (1993/2011) [2014] ZANCHC 2 (7 February 2014) 9 par 22.

<sup>159</sup>Section 86 (11) of the NCA.

(c) the court has made an order, or the consumer and credit providers have made an arrangement, rearranging or consolidating the consumer's obligations and the consumer has fulfilled these obligations.<sup>160</sup>

In terms of section 88 (3), a credit provider who has received notice of court proceedings contemplated in terms of section 83<sup>161</sup> or section 85<sup>162</sup> or a notice from a debt counsellor in terms of section 86 (4)(b)(i),<sup>163</sup> may not exercise or enforce by litigation or other judicial process any right or security under the credit agreement until the consumer is in default under the credit agreement, and either one of the events mentioned above has occurred or the consumer has defaulted in terms of a re-arrangement agreed between the consumer and credit providers, or ordered by the court or the Tribunal.

#### **2.5.4 LILA debtors and debt review and debt re-arrangement**

The debt review process and debt relief mechanisms provided by the NCA apply only in respect of obligations arising out of credit agreements, as set out in section 8 of the NCA. Therefore it offers no relief in respect of other types of debt. According to Roestoff and Coetzee,<sup>164</sup> 'debt review, like administration, amounts to no more than a reorganisation of the consumer's credit agreement debt without providing any discharge'. Therefore, a LILA debtor, who has the wherewithal to successfully apply for debt review and debt re-arrangement by order of the magistrate's court, would be likely to remain in debt servitude for an extended period,<sup>165</sup> as would similarly be the position under an administration order, discussed above.<sup>166</sup> This therefore prolongs the over-indebtedness of the debtor instead of assisting the over-indebted debtor.<sup>167</sup> Compared to sequestration, to undergo debt review does not require proof of 'advantage to creditors'. However, another significant difference between sequestration, on the one hand, and debt review and debt re-arrangement, on the other, which would have an adverse impact for a LILA debtor, is that the latter process does

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<sup>160</sup>S 88 (1) - (2) of the NCA.

<sup>161</sup>In terms of this section the court may declare that a credit agreement is reckless and may suspend it or set it aside.

<sup>162</sup>In terms of this section the court may declare that the consumer is over-indebted and provide relief to the consumer from over-indebtedness.

<sup>163</sup>This is a notice that the debtor has applied for debt review.

<sup>164</sup>M Roestoff and H Coetzee 'Consumer debt relief in South Africa; Lessons from America and England; and suggestions for the way forward' *SA Merc L J* (2012) 53, 69. See also Boraine and Roestoff (note 120 above) 360.

<sup>165</sup>Roestoff and Coetzee (note 164 above). See also Boraine and Roestoff (note 120 above) 359.

<sup>166</sup>See 2.4.5 above.

<sup>167</sup>Boraine and Roestoff (note 120 above) 359.

not offer any measure of discharge from liability for debt as the NCA envisages that all debts will be paid in full.<sup>168</sup>

## **2.6 Reform initiatives in South Africa**

### **2.6.1 Background**

A number of proposals have been put forward, during more than the past decade, which would have the effect of reforming aspects of consumer debt relief measures that are available.<sup>169</sup> However, of these, it is only the NCA that has thus far seen the light of day. Mostly on account of poor drafting, the NCA already requires amendment and the National Credit Amendment Act 19 of 2014 has been enacted.<sup>170</sup> All that remains is for the effective date to be announced. Other proposals for reform that have a bearing on sequestration and on administration orders will be discussed briefly.

### **2.6.2 Draft Insolvency Bill 2000**

After a review of the South African law of insolvency that lasted more than ten years, in 2000, the South African Law Reform Commission published its report, including a Draft Insolvency Bill and a memorandum. Two notable aspects may be mentioned here. First, despite calls by various commentators to do away with the creditor orientated insolvency system,<sup>171</sup> the requirement of ‘advantage to creditors’ was retained in the Draft Insolvency Bill.<sup>172</sup> Another significant proposal by the South African Law Reform Commission was for the insertion of a new section 74X in the Magistrates’ Courts Act, which would provide for a pre-liquidation composition between a debtor and his or her creditors in terms of which the majority of creditors could bind the minority.<sup>173</sup> The proposed section 74X was never enacted, but it is still ‘on the table’ in the form of section 118 of the latest 2013 unofficial amended version of the original Draft Insolvency Bill, which is now referred to as the Insolvency Bill. According to Steyn<sup>174</sup>

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<sup>168</sup>Roestoff and Coetzee (note 164 above). See also Boraine and Roestoff (note 120 above) 359.

<sup>169</sup>For discussion, see Coetzee and Roestoff (note 6 above) 199.

<sup>170</sup>National Credit Amendment 19 of 2014 *Government Gazette* 37665 19 May 2014.

<sup>171</sup>Boraine (note 91 above) 217; Boraine and Roestoff (note 32 above) 109.

<sup>172</sup>S 3 (8) (a) (ii) of the Insolvency Bill. See also A Boraine and M Roestoff ‘Fresh start procedures for consumer debtors in South African bankruptcy law’ 11 *Int. Insolv. Rev.*, (2002) 1, 8.

<sup>173</sup>Clause 11 of the Draft Insolvency Bill of 2000 which forms part of the *Report on the Review of the Law of Insolvency* Project 63 February 2000. See also Coetzee and Roestoff (note 6 above) 199.

<sup>174</sup>Steyn (note 91 above) 143. Boraine and Roestoff (note 172 above). See also Boraine (note 27 above) 197.

‘Various aspects of the proposed procedure were unclear, including, for example, that it did not indicate what the relationship would be between the pre-liquidation composition and debt relief measures, such as administration orders, and whether the pre-liquidation composition process would become a pre-requisite for every insolvency case.’

The procedure is commenced by an over-indebted debtor who wants to offer their creditors a composition.<sup>175</sup> The total debt is not supposed to exceed R200 000.<sup>176</sup> The section requires a majority of concurrent creditors that accounts for two thirds in value must vote in favour of the composition.<sup>177</sup> Secured creditors and preferent creditors will not be affected by the composition unless they consent in writing to it.<sup>178</sup> At acceptance of the composition, the debtor signs a copy of the composition and completes a sworn statement with the administrator.<sup>179</sup> The procedure is administrative in nature since it is administered by the administrator. The composition becomes binding on all creditors who received notice of the hearing or who appeared at the hearing.<sup>180</sup> The application for composition and application for the administration order can also be converted to liquidation proceedings.<sup>181</sup> Upon acceptance of the composition, the debtor may apply for rehabilitation without the requirement of advantage to creditors.<sup>182</sup> According to Roestoff and Coetzee,<sup>183</sup> ‘the proposed measure is supposed to afford debt relief to debtors who cannot show an advantage to creditors and are therefore excluded from the liquidation process’. This proposed statutory pre-liquidation composition therefore poses a potential opportunity for a measure of relief for LILA debtors. However, Boraine and Roestoff submit that:<sup>184</sup>

‘the current proposals of the South African Law Reform Commission will not, if implemented, address the ineffectiveness of the South African insolvency system to provide proper debt relief to insolvent or over-indebted individuals.’

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<sup>175</sup>S 118 (1) of the Insolvency Bill.

<sup>176</sup>Ibid.

<sup>177</sup>Ibid s 118 (17).

<sup>178</sup>Ibid.

<sup>179</sup>Ibid s 118 (1).

<sup>180</sup>See (note 177 above).

<sup>181</sup>S 3 (8) (a) (iv) of the Insolvency Bill.

<sup>182</sup>Ibid s 101 (1) (b).

<sup>183</sup>Roestoff and Coetzee (note 164 above) 70.

<sup>184</sup>A Boraine and M Roestoff ‘Revisiting the state of consumer insolvency in South Africa after twenty years: The courts’ approach, international guidelines and an appeal for urgent law reform’ (Part 2) 77 *THRHR* (2014) 527, 529.

### 2.6.3 Reform of administration orders

Abuse of the administration process became rife,<sup>185</sup> which led to an investigation into potential reform.<sup>186</sup> The investigation came to a halt pending the enactment of the NCA, although it has been brought back to life.<sup>187</sup> There are, currently, proposals that the administration order should have a time limitation whereby the debt will lapse at a statutory stipulated time unlike lapsing at discharge of the costs and full payment of creditors.<sup>188</sup> According to Boraine<sup>189</sup> with reference to the proposals he submitted that ‘the fact that there is no time limitation is also a concern especially in view of some international norms<sup>190</sup> where a three to five year period for repayment plans of this nature applies’.

### 2.7 Preliminary comments on the position of a LILA debtor in relation to debt relief options in South Africa

Even though a common law compromise with creditors is potentially and theoretically at the disposal of a LILA debtor, it is not a realistic option. It is an unlikely prospect, due to a lack of assets and income, that a LILA debtor would be in a financial position to make a reasonable offer of a feasible compromise that would be attractive to a creditor. Very few creditors would agree to such a risky compromise in a non-statutory mechanism that they would not necessarily trust.<sup>191</sup>

Further, realistically, it is unlikely that a debt-stressed LILA debtor, with insufficient funds to enable him or her to enlist the services of a legal representative, would be in a position to reach, or even to negotiate, compromises with all of his or her creditors.

While, for all debtors, sequestration seems an attractive option on account of the discharge from liability for debt that comes with consequent rehabilitation, as discussed above,<sup>192</sup> having to meet the ‘advantage to creditors’ requirement in order for a sequestration order to

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<sup>185</sup>See 2.4.5 above. Allegations of abuse continue; see Beamish (note 129 above).

<sup>186</sup>See Boraine (note 27 above) 201; Boraine (note 27 above) 188.

<sup>187</sup>Coetzee and Roestoff (note 6 above) 197.

<sup>188</sup>Boraine and Roestoff (note 184 above) 528. See also Boraine and Roestoff (note 32 above)100; see also A Boraine, C van Heerden and M Roestoff ‘A comparison between formal debt administration and debt review – pros and cons of these measures and suggestions for law reform’ (Part 2) *De Jure* (2012) 254, 269. See also Steyn (note 91 above) 143. See further the media statement released by the South African Law Reform Commission concerning the review of administration orders Project 127 available at <http://www.justice.gov.za/salrc/media/2008%2003%2007%20Media%20statement%20Questionnaire%20Administration%20Orders.pdf> accessed on 21 July 2014.

<sup>189</sup>Boraine (note 27 above) 201.

<sup>190</sup>These norms will be discussed in Chapter Three.

<sup>191</sup>Boraine and Roestoff (note 32 above) 105.

<sup>192</sup>See 2.3.5 above.

be granted, is an insurmountable hurdle for a LILA debtor to overcome. This is because a LILA debtor has few assets and minimal disposable income or other means to cover the costs of the procedure and for sale of assets to yield a dividend for creditors. Further, to add to the burden, the cost of legal representation and litigation in the high court, in order to obtain this form of relief, would be prohibitive factors for a LILA debtor.

Therefore, although the procedure provides for debt discharge, it is only limited to a certain type of debtor – one who can afford high court litigation and in respect of whose estate sequestration would yield a non-negligible dividend for creditors. It may therefore be stated that the procedure differentiates between different types of debtor. This view is supported by Evans, who submits that:<sup>193</sup>

‘Insolvency legislation invariably almost overreaches itself in regulating the position of the different classes of creditors. However, the debtor is apparently merely defined, with no further attention being given to him, her or it. Although the Act does not provide for different classes of debtors who are treated differently in accordance with differing or changing circumstances, it does in fact differentiate between those ‘rich debtors’ who are able to prove advantage to creditors, and the ‘poor debtors’ who cannot. This raises the question whether, under present legislation, the door has been opened for these ‘poor debtors’ to question the constitutionality of their position.’

Sequestration by voluntary surrender may therefore be said to be inaccessible for a LILA debtor.

In addition, creditors find it practically impossible compulsorily to sequester the estate of a LILA debtor for similar reasons: a creditor will have difficulty proving to the court that there is reason to believe that sequestration will be to the ‘advantage of creditors’. Roper J, in *Meskin and Co v Friedman*,<sup>194</sup> held that, ‘the facts before the court must satisfy it that there is a reasonable prospect not necessarily a likelihood, but a prospect which is not too remote that some pecuniary benefit will result to the creditors’. Roper J<sup>195</sup> added that the fact that there are no assets is not important but ‘even if there is none at all, but there are reasons of thinking that, as a result of enquiry under the Act, some assets may be revealed or recovered for benefit of creditors, that is sufficient’. It would therefore be a waste of a creditor’s

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<sup>193</sup>Evans (note 50 above) 508. As pointed out by Evans, differentiation between those whose estates can be sequestrated and those whose cannot is clearly shown in the case of *Van Rooyen v Van Rooyen* 2000 2 ALL SA 485 (SE).

<sup>194</sup>*Meskin and Co* (note 51 above) 558.

<sup>195</sup>*Ibid* 559.

resources to apply for a LILA debtor's sequestration. Further, friendly sequestration would be a likely proposition because of the lack of means of the debtor himself or herself.

As shown above, the administration order is an alternative to sequestration specifically designed for a debtor with minimum assets and limited debts. The order is available to an over-indebted debtor who cannot meet the 'advantage to creditors' requirement and whose debt does not exceed R50 000.<sup>196</sup> Therefore, a LILA debtor whose debt exceeds R50 000 cannot obtain this form of debt relief. It must also be borne in mind that the administration order does not include *in futuro* debts. This would mean that, instead of having his or her debt administered under a single debt relief measure, the LILA debtor would have the frustration of paying *in futuro* debts, which would apparently include future instalments payable under credit agreements, in addition to the payments required in terms of the administration order. This would likely impact the LILA debtor negatively, as was discussed above.<sup>197</sup>

The administration procedure does not have a debt discharge provision and therefore all debts must be paid in full.<sup>198</sup> This negatively affects a LILA debtor, who has minimal excess income to apply to payments, which would need to be set very low. This, in turn, would mean that the debts would take an inordinately long time to pay. Another factor would be that interest and administration costs would further escalate the total amount payable. Bearing in mind also that section 74 of the MCA does not impose a limitation on the duration of an administration order; the result is that a LILA debtor would be likely to remain in debt servitude for a very long time, if not for his or her entire life.<sup>199</sup>

As discussed above,<sup>200</sup> the debt review procedure provides relief to a debtor with debts arising out of 'credit agreements' as defined in the NCA. A LILA debtor who cannot meet the 'advantage to creditors' requirement and whose total debt exceeds R50 000 would have to resort to the debt review procedure. However, a LILA debtor whose debt is not 'credit agreement' debt would have no other option available to him or her but will be left to the mercy of creditors. Thus, one can say that the system is one of 'all or nothing' since it determines who can and who cannot get debt relief and it is possible that some, particular LILA debtors, will have no debt relief option at their disposal.

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<sup>196</sup>S 74 (1) (b) of the MCA read with GN 1441, *Government Gazette* 19435 of 30 October 1998, with effect from 1 November 1998.

<sup>197</sup>See 2.4.5 above.

<sup>198</sup>See (note 114 above).

<sup>199</sup>Boraine (note 27 above) 190. Boraine, van Heerden and Roestoff (note 188 above) 265.

<sup>200</sup>See 2.5.1 above.

Further, even if a LILA debtor can obtain debt relief under the NCA, because it does not provide for debt discharge, there will be no opportunity to obtain a ‘fresh start’ as would a debtor whose estate had been sequestrated.

The debt relief mechanisms under the MCA and NCA, both, falls short of Spooner’s submission in relation to debt discharge:<sup>201</sup>

‘Debt discharge allows personal insolvency law to alleviate poverty and deprivation among the inevitable financial failed households and safeguard the basic needs of all society members, while removing households from financial exclusion by providing a fresh start.’

## **2.8 Conclusion**

The South African debt relief measures’ entry requirements clearly show that each one has limited applicability. Each of the available mechanisms targets a certain type of debtor and, for the most part, LILA debtors will be excluded. Sequestration is not an option for a LILA debtor because ‘advantage to creditors’ will not be established. Even though some LILA debtors may qualify to undergo debt review and debt re-arrangement under the NCA, and/or for administration under the MCA, it is imperative to note that there is no form of discharge afforded to a debtor in either of these circumstances. The on-going abuse under the administration process, and the costs and fees involved, make the mechanism unfavourable for a LILA debtor. Clearly, the system in South Africa does not strike a balance between the interests of debtors, and particularly LILA debtors, and their creditors. This therefore calls for the legislature to revisit this area of law.

The next chapter will provide a brief comparison of consumer debt relief mechanisms available to LILA debtors in foreign jurisdictions.

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<sup>201</sup>J Spooner ‘Personal Insolvency law in the modern consumer credit society: English and comparative perspectives’ unpublished doctoral thesis (University of London) 2013 74, cited with permission of the author. A similar sentiment is expressed in the *World Bank Report* which states that ‘One of the principal purposes of an insolvency system for natural persons is to re-establish the debtor’s economic capability, in other words, *economic rehabilitation*’. See *World Bank Report* (note 6 above) par 359.

## CHAPTER THREE: DEBT RELIEF MEASURES AVAILABLE TO LILA DEBTORS IN FOREIGN JURISDICTIONS

‘If access to debt relief is too hard then people will be stuck in a debt trap with no chance of escape. If access is too easy then creditors will lose money that could and should have been paid. A balance must be struck, but debtors should be able to bankrupt themselves if they are genuinely unable to pay their debts.’ (A Wilson)<sup>202</sup>

### 3.1 Introduction

Consumer over-indebtedness is a worldwide phenomenon. In an attempt to address this predicament a number of countries have implemented remedial measures to deal with over-indebtedness and in an endeavour to ensure that debtors obtain a ‘fresh start’.<sup>203</sup> It may be noted that low income is a feature which is regarded as an obstacle in the way of debtors’ overcoming over-indebtedness.<sup>204</sup> In this chapter a broad, comparative survey will be undertaken of legal provisions applicable in various countries, namely, the United States of America, England and Wales, Scotland, Ireland and New Zealand, which cater for LILA debtors.

### 3.2 The United States of America

#### 3.2.1 Background

Originally, in the United States of America (USA), bankruptcy laws provided for creditor-orientated remedies against the debtor derived from the English bankruptcy laws in terms of which debtors who tried to avoid their debts were imprisoned.<sup>205</sup> The reasoning behind this was to thwart fraudulent deeds by debtors, notwithstanding the fact that the bankruptcy laws did not provide rehabilitation to a truthful but unfortunate debtor.<sup>206</sup> This position was later changed, influenced by the English law which transitioned in the 18<sup>th</sup> century in the direction

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<sup>202</sup>A Wilson, Deputy Minister for Enterprise and lifelong learning, see Accountant in Bankruptcy, ‘Low income, low asset – A new route into bankruptcy’ Consultation on proposed regulations April 2007 available at <http://www.scotland.gov.uk/Resource/Doc/174131/0048565.pdf> accessed on 17 September 2014.

<sup>203</sup>See, for example, INSOL International *Consumer Debt Report II: Report of findings and recommendations* 2011; Coetzee and Roestoff (note 6 above); J Spooner ‘Long overdue: What the belated reform of Irish Personal Insolvency law tells us about comparative consumer bankruptcy’ 86 *The American Bankruptcy Law* (2012) 243. For the term ‘fresh start’ see (note 8 above).

<sup>204</sup>S Stamp ‘The impact of debt advice as a response to financial difficulties in Ireland’ 11 *Social Policy and Society* (2012) 93, 96.

<sup>205</sup>See references in A Boraine and M Roestoff ‘Developments in America Consumer Bankruptcy law Lessons for South Africa’ (Part 1) *Obiter* (2000) 33, 36; P B Lewis ‘Can’t pay your debts, mate? A comparison of the Australian and American Personal Bankruptcy systems’ *Bankruptcy Development Journal* (2002) 297, 298.

<sup>206</sup>Lewis (note 205 above) 299.

of granting debt discharge to a debtor.<sup>207</sup> The American bankruptcy law developed further ultimately leading to the promulgation of the Bankruptcy Reform Act of 1978 (Bankruptcy Code). The bankruptcy laws in the United States of America were elucidated in the US Supreme Court case of *Local Loan Co v Hunt*.<sup>208</sup> The court held that one of the primary purposes of the federal bankruptcy laws:

‘...is to relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes...’

The USA federal bankruptcy laws are regarded as having provided an example for several international law reform initiatives due to the easing of the previous, strict prerequisites for debt discharge.<sup>209</sup> The reasoning behind this is to provide a debtor who is in a financial predicament a ‘fresh start’. This goal is accomplished through the bankruptcy discharge, which releases debtors from personal liability from specific debts and forbids creditors thereafter from ever taking any action or recourse against the debtor.<sup>210</sup>

The Bankruptcy Code provides consumer debtors with two primary alternatives by means of which to obtain debt relief. These alternatives are located in Chapter 7 and Chapter 13, respectively. In terms of Chapter 7, the debtor’s assets are liquidated and he or she receives an immediate debt discharge. On the other hand, Chapter 13 allows for the re-organisation of a debtor’s prepetition debt and finally, on completion of a repayment plan, a discharge of the prepetition debt.<sup>211</sup> The procedure requires regular income.<sup>212</sup> Each alternative suits a particular type of debtor. In the case of LILA debtors, where there are insufficient non-exempt assets available for sale and inadequate surplus income to discharge towards a repayment plan under Chapter 13, only the Chapter 7 procedure would be of relevance. This will be now discussed.

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<sup>207</sup>Ibid.

<sup>208</sup>*Local Loan Co v Hunt* 292 US 234, 244 (1944). This case is regularly cited by authors, including J Calitz ‘Developments in the United States consumer bankruptcy law: A South African perspective’ *Obiter* (2007) 397, 400.

<sup>209</sup>Calitz (note 208 above) 400.

<sup>210</sup>Lewis (note 205 above) 297.

<sup>211</sup>Lewis (note 205 above) 303.

<sup>212</sup>*Consumer Debt Report II* (note 203 above) 303.

### 3.2.2 Chapter 7 liquidation procedure

The Bankruptcy Code states that for a debtor to be eligible for relief under Chapter 7, the debtor may be an individual, a partnership or corporation or any other business entity.<sup>213</sup> It further states that a joint petition may be filed by a husband and a wife.<sup>214</sup> The procedure may be used by a debtor, whether solvent or insolvent, and there is no limitation on the amount of debt. The Bankruptcy Code, as amended by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) introduced a ‘means test’ which determines if the debtor is eligible for the Chapter 7 liquidation procedure or whether he or she is obliged to follow the Chapter 13 debt rescheduling procedure. The BAPCPA ‘means test’ is income based and is designed to allow only those who truly cannot pay their debts to use the Chapter 7 procedure. Calitz<sup>215</sup> submits that ‘the enactment of the BAPCPA in the USA has reversed the liberal “fresh start” attitude and adopted a stance considerably more conservative in its philosophy as was the case previously’. The BAPCPA introduced measures to curtail abuse, prohibit fraud and crime related debts.<sup>216</sup>

There is no requirement for a debtor to prove that the process will lead to the ‘advantage of creditors’. However, the BAPCPA requires a debtor who is filing for debt relief under Chapter 7 or, for that matter, any other Chapter of the Bankruptcy Code, within 180 days before filing to receive credit counselling from an approved credit counselling agency either in an individual or a group briefing.<sup>217</sup>

The Chapter 7 procedure is characterised by an orderly, court supervised procedure,<sup>218</sup> which is simple and inexpensive.<sup>219</sup> The debtor is required to pay a certain fee. If a debtor fails to pay the fee this may result in dismissal of the case.<sup>220</sup> However, a court may waive payment of the fee<sup>221</sup> or may allow the debtor to pay the fee in instalments in circumstances where he or she is unable to discharge it in a single payment.<sup>222</sup> Such debtor should have an income

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<sup>213</sup> 11 U.S.C §§ 101 (41), 109(b).

<sup>214</sup> 11 U.S.C § 302(a).

<sup>215</sup> Calitz (note 208 above) 399.

<sup>216</sup> J Ferriell and E Janger *Understanding Bankruptcy* 3 ed Lexis Nexis (2013) 3; Y Schlecter ‘Before and after Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 examined under recent case law: A curse in disguise for consumers?’ *W L R* (2006) 787, 787.

<sup>217</sup> 11 U.S.C §§ 109, 111.

<sup>218</sup> See note 213 above.

<sup>219</sup> Lewis (note 205 above) 303.

<sup>220</sup> 11 U.S.C § 707(a).

<sup>221</sup> 28 U.S.C §§ 1930(f).

<sup>222</sup> *Ibid*; Bankruptcy Court Miscellaneous Fee Schedule, Item 8.

which is less than 150% of the poverty level, as defined in the Bankruptcy Code.<sup>223</sup> Upon acceptance of the petition, the process allows the trustee to collect, liquidate and realise the debtor's assets and this will be followed by a distribution of the proceeds to the creditors.<sup>224</sup>

The Bankruptcy Code allows a debtor to keep certain property that is exempted under the federal bankruptcy laws or under the laws of the debtor's home state.<sup>225</sup> Evans<sup>226</sup> submits that this property will empower a debtor to have a 'fresh start'. Ferriell and Janger<sup>227</sup> submit that the 'fresh start' is not available to every debtor but only to a truthful debtor and that this shows that there is an ethical aspect to it which cannot be overlooked. It is Evans's<sup>228</sup> submission that usually, in Chapter 7 cases, the debtors have insufficient non-exempt property, hence there may not be any real liquidation of the debtor's assets and the debtor is discharged promptly since there will be no sale. These may be referred to as 'no asset cases'.<sup>229</sup> However, in cases where there *are* assets creditors will get a dividend from the realised assets realised by the trustee. A debtor has a choice whether to pay the secured debts under a reaffirmation agreement<sup>230</sup> or to surrender the secured property.<sup>231</sup>

### 3.2.3 The moratorium

A petition under Chapter 7 grants the debtor a moratorium against enforcement of his debt by creditors.<sup>232</sup> This 'automatic stay' therefore bars creditors from using enforcement actions such as wage garnishments and from bringing lawsuits against the debtor. However, certain types of actions against the debtor are not prohibited by the Bankruptcy Code.<sup>233</sup>

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<sup>223</sup>See note 221 above.

<sup>224</sup>11 U.S.C §§701,704. A successful petition of Chapter 7 is followed by appointment of an impartial trustee by the United States Trustee (or the Bankruptcy Court in Alabama and North Carolina), who will administer the case and liquidate the debtor's non-exempt assets. See also Lewis (note 205 above), 305.

<sup>225</sup>11 U.S.C §§ 522(b).

<sup>226</sup>Evans (note 14 above) 346.

<sup>227</sup>Ferriell and Janger (note 216 above) 2 - 3.

<sup>228</sup>Ibid 607. See also Evans (note 14 above) 342.

<sup>229</sup>Ferriell and Janger (note 216 above) 607.

<sup>230</sup>Roestoff and Coetzee express that '[r]eaffirmation, in essence, entails a promise by the debtor to pay a debt despite its discharge. Reaffirmations are apparently only appropriate when a debtor is in arrears with payments of secured debts and does not wish to pursue Chapter 13 to deal with the problem. Acceptance of the offer of reaffirmation enables the debtor to keep the encumbered property and pay the debt over time. Reaffirmations of unsecured debts would, however seldom, if ever benefit the debtor'; Roestoff and Coetzee (note 164 above) 72.

<sup>231</sup>Ferriell and Janger (note 216 above) 449 - 450.

<sup>232</sup>11 U.S.C § 362.

<sup>233</sup>11 U.S.C §§ 362 (b) outlines the type of actions that are not affected by the moratorium. Examples are the continuation or commencement of a criminal action against the debtor, actions concerning child custody or visitation and the commencement and continuation of a civil action.

### 3.2.4 Debt discharge

Chapter 7 of the Bankruptcy Code provides an automatic debt discharge to an individual debtor but not to corporations and partnerships.<sup>234</sup> In some cases, the court may revoke the discharge where it was obtained as a result of fraud.<sup>235</sup> Discharge will not be granted in cases where the debtor was granted a discharge within the last eight years of the filing in the present case.<sup>236</sup> Furthermore, not all debts are dischargeable under the Chapter 7 of the Bankruptcy Code.<sup>237</sup> Non-dischargeable debts include an obligation to pay alimony, to provide child support, to pay certain taxes, and to discharge debts for certain educational benefit overpayments or loans made or guaranteed by a government unit, and debts owing as damages for wilful and malicious injury.<sup>238</sup> Chapter 7 of the Bankruptcy Code achieves two things: the liquidation of the debtor's assets, followed by debt discharge.<sup>239</sup> According to Roestoff and Coetzee,<sup>240</sup> there is no connection between the suitability for discharge and the amount paid towards the creditors. The discharge is applicable to unsecured debts only.<sup>241</sup> The procedure therefore allows a debtor a speedy discharge from liability for debt.<sup>242</sup>

## 3.3. England and Wales

### 3.3.1 Background

The modern bankruptcy system in England and Wales is based on the 'fresh start' policy.<sup>243</sup> The Enterprise Act of 2002, which came into effect on 1 April 2004, introduced liberal changes that reflected the legislative purpose of, *inter alia*, striking a balance between the interests of creditors and debtors. An example is that, previously, debtors in England and Wales who had been declared bankrupt were discharged after three years. However, the Enterprise Act amended the Insolvency Act 1986 to provide for automatic discharge after one year.<sup>244</sup> Thus McKenzie Skene and Walters<sup>245</sup> aptly describe bankruptcy as 'a debt relief tool

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<sup>234</sup> 11 U.S.C §§ 727 (a) (i).

<sup>235</sup> 11 U.S.C § 727 (d).

<sup>236</sup> 11 U.S.C § 727 (a) (8).

<sup>237</sup> 11 U.S.C §§ 523 (a).

<sup>238</sup> *Ibid*, the section further outlines some more types of debts that are not dischargeable.

<sup>239</sup> D L Balser 'Section 707(b) of the Bankruptcy Code: A Roadmap with a Proposed Standard for Defining Substantial Abuse' 19 *University of Michigan Journal of Law Reform* (1986) 1011, 1013.

<sup>240</sup> Roestoff and Coetzee (note 164 above) 72.

<sup>241</sup> *Ibid*.

<sup>242</sup> Evans (note 14 above) 342.

<sup>243</sup> IF Fletcher *The Law of Insolvency* 4 ed Sweet and Maxwell (2009) 142; A Walters 'Individual voluntary arrangements: A "fresh start" for salaried consumer debtors in England and Wales' 18 *International Insolvency Review* (2009) 5, 13.

<sup>244</sup> Walters (note 243 above) 12.

taking the form of a statutory composition designed to balance the interests of debtors and creditors’.

There are five procedures available to individual debtors in England and Wales. One is in terms of the common law, the debt management plan (DMP). There are also four formal, statutory procedures: bankruptcy;<sup>246</sup> individual voluntary arrangement (IVA), also provided for by the Insolvency Act of 1986, as amended by the Enterprise Act 2002 as well as the Insolvency Rules 1986 with 2010 amendments; the county court administration order (CCAO), provided for by the County Courts Act 1984; and the debt relief order (DRO) provided for by the Insolvency Act 1986, as amended by the Tribunals, Courts and Enforcement Act of 2007.<sup>247</sup>

It may be noted that, in England and Wales, as a general rule, the debtor has the option to choose which particular debt relief procedure suits him or her; the decision is not made by the administrative body or the court. Although an option for a LILA debtor may be a DMP, which would lead to rescheduling of debts and consolidated into a single monthly payment for distribution to creditors,<sup>248</sup> the need for the debtor to have a measure of surplus income would probably render this unsuitable. In order to enter bankruptcy, a debtor is required to pay an initial sum of, currently, £705 (a deposit fee of £525 and a court fee of £180).<sup>249</sup> The fee requirement makes it impossible for a LILA debtor to access bankruptcy although it may, however, be waived where a debtor cannot afford it.<sup>250</sup> The IVA, provided for in Part VIII of the Insolvency Act 1986, is a binding consensual arrangement between a debtor and a creditor on terms set out in a proposal for a repayment plan drawn up with the assistance of an Insolvency Practitioner. For a LILA debtor with insufficient surplus income to apply towards a repayment plan, an IVA would not be an option. CAAOs, in terms of the County Courts Act 1984, were designed for debtors with debts of less than £5000, with not more than one county court or High Court judgment debt and with limited assets. One payment per month to the local court would be required and the court would distribute the money to creditors. Therefore, this procedure would be a possible option for LILA debtors, although,

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<sup>245</sup>D McKenzie Skene and A Walters ‘Consumer bankruptcy in Great Britain’ 80 *Am Bank L J* (2006) 477, 481.

<sup>246</sup>Provided for in the Insolvency Act 1986 Part IX.

<sup>247</sup>Which became effective on 6 April 2009.

<sup>248</sup>Walters (note 243 above) 21- 22.

<sup>249</sup>Declaring bankruptcy or being made bankrupt available at <https://www.gov.uk/bankruptcy/declare-bankruptcy> accessed on 20 December 2014.

<sup>250</sup>Court – Fees Ministry of Justice HM Courts and Tribunals Service *Court and Tribunal fees* available at <https://www.justice.gov.uk/courts/fees> accessed on 20 December 2014.

again, only if there is any surplus income to be paid into court each month. The debtor must pay a fee of 10% of the amount of each payment. The debts must be paid in full. CCAOs have largely fallen into disuse.<sup>251</sup> The DRO, was introduced specifically as a ‘no income, no assets’ (NINA) procedure for the relief of debtors who had virtually no surplus income and no significant assets.<sup>252</sup> The DRO will therefore now be discussed.

### 3.3.2 Debt relief order (DRO)

The DRO was enacted to fill *lacunae* that previously existed in the provision of debt relief for those who could not pay their debts.<sup>253</sup> Access to a DRO is narrow. The debtor is required to pay a £90 entrance fee.<sup>254</sup> To be eligible for a DRO, the debtor must: not owe more than £15,000; not have assets the total value of which exceeds £300; have a maximum surplus income of £50 per month; and not have already been subject to debt relief order in the last six years.<sup>255</sup> The debts must not fall in the categories of those excluded in terms of the Insolvency Act 1986, which include certain prescribed, secured debts.<sup>256</sup> The Insolvency Service recently held a consultation and is currently conducting a review of the DRO regime with a view to establishing whether the eligibility requirements should be changed and how it may be improved.<sup>257</sup>

Debt relief orders are not court based, but are administrative in nature. Spooner<sup>258</sup> points out that the procedure is a ‘low-cost and procedurally uncomplicated procedure, minimising transaction costs and artificial barriers to entry which exclude “low net worth” debtors whose financial situations nonetheless are liable to trigger externalities’. The debtor makes an application to the Official Receiver through an approved intermediary.<sup>259</sup> In this regard an

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<sup>251</sup>J Spooner ‘Fresh start or stalemate? European consumer insolvency law reform and the politics of the household debt’ 3 *European Review of Private Law* (2013) 747, 756.

<sup>252</sup>See Part 7A of the Insolvency Act 1986. For discussion of the DRO, see P Walton ‘New ways to avoid bankruptcy: a jigsaw puzzle with a piece missing?’ *Corporate Rescue and Insolvency* (2009) 190; J Spooner ‘Long overdue: What the belated reform of Irish personal insolvency law tells us about comparative consumer bankruptcy’ 86 *American Bankruptcy Law* (2012) 243,250.

<sup>253</sup>Section 251A (1) of the Insolvency Act 1986, as amended by the Tribunals, Courts and Enforcement Act of 2007.

<sup>254</sup>Options for paying off your debts available at <https://www.gov.uk/options-for-paying-off-your-debts/debt-relief-orders> accessed on 21 December 2014.

<sup>255</sup>Spooner (note 251 above); Insolvency Service *Insolvency Proceedings: Debt relief orders and the bankruptcy petition limit: Call for evidence* available at [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/341089/Insolvency\\_Proceedings\\_Debt\\_relief\\_orders\\_and\\_petition\\_limits\\_v3.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/341089/Insolvency_Proceedings_Debt_relief_orders_and_petition_limits_v3.pdf) accessed on 30 October 2014.

<sup>256</sup>S 251A (2) and s 251A (3).

<sup>257</sup>For details of the call for evidence and the review, see Insolvency Service’s announcement of the review and *Insolvency proceedings*. See note 255 above.

<sup>258</sup>Spooner (note 201 above) 163.

<sup>259</sup>S 251B (1).

approved intermediary is referred to by section 251U (1) as an individual who is vexed with authority to act as a mediator between an applicant for debt relief order and the Official Receiver. The application must incorporate a list of all debts due, including interest or any other amounts owing, and the creditor to whom each debt is owed.<sup>260</sup> Further, it must contain details of security provided in respect of any of the debts<sup>261</sup> as well as information about the debtor's affairs, including debts and liabilities, his or her income and assets.<sup>262</sup> The Official Receiver has discretion either to accept the application and grant the debt relief order in the prescribed manner<sup>263</sup> in relation to the qualifying debts<sup>264</sup> or to refuse the application.<sup>265</sup>

### **3.3.3 The moratorium**

The debt relief order stays all debt management arrangements that were in force preceding the grant of the order.<sup>266</sup> A moratorium is provided in respect of debts that qualify under the order.<sup>267</sup> The moratorium has the effect that it stays an action for remedy against the debtor by the creditor.<sup>268</sup> Consequently, the creditor may not lodge a petition, including a bankruptcy petition, or take any action or institute legal proceedings against the debtor except where permission is granted.<sup>269</sup> However, secured creditors' rights are not affected, but remain intact.<sup>270</sup> The moratorium applies for one year, commencing on the effective date of the order,<sup>271</sup> although it may be terminated early or extended in certain circumstances.<sup>272</sup>

### **3.3.4 Debt discharge**

Upon the lapse of the moratorium period, ie., after one year from the start date of the DRO, the debtor will be discharged from liability for all the qualifying debts specified in the order

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<sup>260</sup>S 251B (2) (a).

<sup>261</sup>S 251(B) (2) (b).

<sup>262</sup>S 251(B) (2) (c).

<sup>263</sup>S 251E.

<sup>264</sup>S 251C (3) (b).

<sup>265</sup>S 251C (3) (a). In terms of S 251C (4) (a), refusal of the application could either be based on whether the application does not meet the requirements imposed by or under s 251B.

<sup>266</sup>S 251F (2). These would include any administration order, enforcement restriction order and debt repayment plan that was already in place by virtue of any of the other debt relief options available.

<sup>267</sup>S 251G (1).

<sup>268</sup>S 251G (2) (a).

<sup>269</sup>S 251G (2) (b). According to s 251G (3) the court may stay the proceedings on the petition, action or other proceedings as the case may be or allow them to continue.

<sup>270</sup>S 251G (5).

<sup>271</sup>S 251H (1).

<sup>272</sup>S 251H (1) (a) - (b) - (2).

(including all interest, penalties and other sums which may have become payable in relation to those debts since the application date).<sup>273</sup>

### 3.4 Scotland

#### 3.4.1 Background

Before the enactment of the Bankruptcy (Scotland) Act 1985,<sup>274</sup> there were very few personal bankruptcies in Scotland. A reason for this was that a trustee would frequently decline to act where there were insufficient assets, since the trustee's remuneration was paid out of the debtor's assets. In an endeavour to address this situation, provision was made in the Bankruptcy (Scotland) Act 1985, when it was enacted, for public funding to be applied to pay a trustee to administer cases where the debtor had minimal assets.<sup>275</sup>

Bankruptcy law in Scotland has undergone comprehensive reform in recent years and, as a result the Bankruptcy (Scotland) Act 1985 has been amended in a number of significant respects.<sup>276</sup> As McKenzie Skene has outlined, various reforms similar to those introduced in England and Wales by the Enterprise Act, were effected. The period of a debtor's bankruptcy was reduced from three years to one year.<sup>277</sup> Further, provisions were introduced to streamline the sequestration procedure in order to make it more efficient, cost-effective and user-friendly. Sequestration applications by a debtor are now handled by the Accountant in Bankruptcy, instead of the court, and all other bankruptcy procedures are dealt with in the sheriff court,<sup>278</sup> thus relieving the Court of Session of this burden. Most significantly, for purposes of this study, the Bankruptcy and Diligence (Scotland) Act 2007 introduced new provisions to make sequestration more accessible to debtor with little or no assets or income.<sup>279</sup>

The Bankruptcy (Scotland) Act 1985, as amended, offers three debt relief mechanisms, namely, sequestration, the protected trust deed (PTD) and the debt arrangement scheme (DAS). The PTD and DAS require a steady surplus income to be applied to outstanding debts

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<sup>273</sup>S 251I.

<sup>274</sup>The Bankruptcy (Scotland) Act 1985, as amended at 23 November 2009.

<sup>275</sup>M Adler 'The overseas dimension: What can Canada and the United States learn from the United Kingdom' 37 *Osgoode Hall Journal* (1999), 415, 417.

<sup>276</sup>For a clear explanation of this reform, see D McKenzie Skene 'The reform of bankruptcy law in Scotland' 22 *Insolv.Int* (2009) 17, 17.

<sup>277</sup>S 54(1) of the Bankruptcy (Scotland) Act 1985.

<sup>278</sup>The equivalent of South Africa's magistrate's court.

<sup>279</sup>McKenzie Skene (note 276 above) 18.

and, therefore, are not suitable for a LILA debtor. The sequestration procedure, the equivalent of bankruptcy in England and Wales, involves liquidation of a debtor's assets.<sup>280</sup> Prior to the coming into operation of new provisions under the Bankruptcy and Diligence (Scotland) Act 2007, strict entrance criteria and post-bankruptcy restrictions posed insurmountable hurdles for a LILA debtor to obtain debt relief through sequestration.<sup>281</sup> In the circumstances, the legislature introduced a new section 5A into the Bankruptcy (Scotland) Act 1985, via the Bankruptcy and Diligence (Scotland) Act 2007 and supporting regulations<sup>282</sup> that came into operation on 1 April 2008, to facilitate LILA debtors' access to sequestration.<sup>283</sup> The new Bankruptcy (Scotland) Act's low income, low asset (LILA) route into bankruptcy was reviewed by the Accountant in Bankruptcy in 2009 and, although it was found to be a success,<sup>284</sup> the Bankruptcy and Debt Advice (Scotland) Act 2014, which has already received Royal Assent, will in April 2015 bring into effect amendments to the Bankruptcy (Scotland) Act 1985 to repeal the low income, low asset procedure and replace it with a new minimal asset procedure for LILA debtors.<sup>285</sup> Both the current and newly assented to LILA bankruptcy procedures will be discussed below.

### **3.4.2 The low income, low asset route into bankruptcy for LILA debtors**

The procedure is available to a debtor who is unable to pay his or her debts where each of the conditions in section 5A are met.<sup>286</sup> The debtor must pay an application fee of £100, which may be paid in instalments.<sup>287</sup> The debtor's gross weekly income must not exceed £247.60, excluding any social security benefits or income received by any member of the family.<sup>288</sup>

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<sup>280</sup>McKenzie Skene and Walters (note 245 above) 489 - 490.

<sup>281</sup>In terms of S 5(2), (2A) and (2B) of the Bankruptcy Act 1985, prior to amendment by the Bankruptcy and Diligence (Scotland) Act 2007, a debtor was required: to obtain the concurrence of a qualified creditor; to have debts of more than £1,500; not to have received an award of sequestration in the preceding five years; and, lastly, to establish that he or she was insolvent or that he or she had granted a trust deed that had failed to become protected. See McKenzie Skene (note 276 above) 20.

<sup>282</sup>The Bankruptcy (Scotland) Act 1985 (Low Income, Low Asset Debtors etc.) Regulations 2008, SSI 2008/81.

<sup>283</sup>McKenzie Skene (note 276 above) 23.

<sup>284</sup>*The Bankruptcy (Scotland) Act 1985 (Low Income, Low Asset Debtors etc.) Regulations 2008 One Year Review* (October 2009) available at <http://www.aib.gov.uk/publications/lila-one-year-review-2009> accessed on 28 October 2014.

<sup>285</sup>See ss 5 - 7 of the Bankruptcy and Debt Advice (Scotland) Act 2014 which add various new provisions and a new Sch A1 to the Bankruptcy (Scotland) Act 1985. Sch 4 to the Bankruptcy and Debt Advice (Scotland) Act 2014 repeals the current low income, low asset procedure.

<sup>286</sup>S 5 (2B) (c) (ia) of the Bankruptcy (Scotland) Act 1985.

<sup>287</sup>*The Bankruptcy (Scotland) Act 1985 (Low Income, Low Asset Debtors etc.) Regulations 2008 One Year Review* (October 2009) available at <http://www.aib.gov.uk/publications/lila-one-year-review-2009> accessed on 28 October 2014.

<sup>288</sup>This represents 40 times the hourly rate of the national minimum wage. See the Bankruptcy (Scotland) Act 1985 (Low Income, Low Asset Debtors etc.) Regulations 2008 One Year Review (October 2009) available at <http://www.aib.gov.uk/publications/lila-one-year-review-2009> accessed on 28 October 2014; AIB website at

The debtor must not own land<sup>289</sup> nor any single asset worth more than £1,000 and total assets must not be worth more than £10 000.<sup>290</sup> Assets such as household appliances, tools for upkeep of the household and children's toys are exempted.<sup>291</sup> However, the Bankruptcy (Scotland) Act 1985 makes further provision, in terms of section 5B, that a certificate of sequestration may be granted to a debtor who is unable to pay his or her debts as they fall due. This therefore makes it easier for a LILA debtor who is unable to fulfil the conditions for application which are set out in section 5A.

The debtor's application for sequestration may be determined by the Accountant in Bankruptcy. The sheriff also has jurisdiction in respect of the debtor's petition for sequestration.<sup>292</sup> The process is therefore administrative in nature and there is no court process involved – a change from the previous position where the Court of Session awarded or recalled bankruptcies.<sup>293</sup> The award of sequestration shall be made by the Accountant in Bankruptcy where he or she is satisfied that the application is made in accordance with the provisions of the Act and any other provisions under the Act.<sup>294</sup>

### 3.4.3 Debt Discharge

A debtor receives a discharge automatically after a period of one year after the date of sequestration.<sup>295</sup> The discharge has the effect of discharging all the debts and obligations that were subject to the sequestration.<sup>296</sup> There are various types of debts that are not dischargeable.<sup>297</sup> A discharged debtor has to apply to the Accountant in Bankruptcy for the

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<http://www.aib.gov.uk/Services/Legislation/accesstobankruptcy/Debtorsapplication/Lila> accessed 6 December 2014.

<sup>289</sup>S 5A (3) of the Bankruptcy (Scotland) Act 1985.

<sup>290</sup>S 5A (4) of the Bankruptcy (Scotland) Act 1985 and reg 3(1) and (2) of the Bankruptcy (Scotland) Act 1985 (Low Income, Low Asset Debtors etc.) Regulations 2008.

<sup>291</sup>The Bankruptcy (Scotland) Act 1985 (Low Income, Low Asset Debtors etc.) Regulations 2008 One Year Review available at <http://www.aib.gov.uk/publications/lila-one-year-review-2009> accessed on 28 October 2014.

<sup>292</sup>S 9 (1) and s 9 (1A).

<sup>293</sup>Accountant in Bankruptcy Scotland Insolvency Service *Changes for debtors and Creditors* available at <http://www.aib.gov.uk/guidance/main-changes-debtors-and-creditors> accessed on 30 October 2014.

<sup>294</sup>S 12 (1) (a).

<sup>295</sup>S 54 (1).

<sup>296</sup>S 55 (1).

<sup>297</sup>S 55 (2). These debts include liability to pay a fine or other penalty due to the Crown, debts related to fraud or breach of trust, liability under a compensation order within the meaning of section 249 of the Criminal Procedure (Scotland) Act 1995, child support maintenance, and student loan debts.

issuing of a certificate of discharge.<sup>298</sup> However, a trustee or creditor may lodge an application to defer the debtor's discharge.<sup>299</sup>

### 3.4.4 The prospective minimal assets procedure for LILA debtors

Sections 5 to 7 of the Bankruptcy and Debt Advice (Scotland) Act 2014 will introduce new provisions and a new Schedule A1 into the Bankruptcy (Scotland) Act 1985, thus creating a new sequestration procedure where a debtor 'has few assets'. To be eligible to use this procedure, the debtor must be assessed by 'the common financial tool' as not having to make a debtor's contribution or the debtor must be in receipt of a prescribed payment for a period of at least six months preceding the date of application.<sup>300</sup> The debtor's total debt must not be less than £1500 and should not exceed £1700.<sup>301</sup> Further, the total value of the debtor's assets must not exceed £2000<sup>302</sup> and the value of any single asset of the debtor should not exceed £1000.<sup>303</sup> The debtor must not own land.<sup>304</sup> The debtor will also be able to utilise this procedure where the debtor has within the prescribed period been granted a certificate for sequestration of the estate in accordance with section 5B of the Bankruptcy (Scotland) Act 1985.<sup>305</sup> The debtor will be barred from using this minimal asset procedure if he has used it in the last ten years, or if he has been sequestrated in the last five years<sup>306</sup> Provision is made for assets, which would be excluded from vesting in the Accountant in Bankruptcy as trustee, likewise to be excluded in this minimal assets procedure<sup>307</sup> and the debtor will be allowed to keep and make use of a vehicle the value of which does not exceed£3000.<sup>308</sup> The award of sequestration will be made by the Accountant in Bankruptcy.<sup>309</sup>

In terms of a new section 54C of the Bankruptcy (Scotland) Act 1985, the debtor will receive discharge from debt six months after the date on which sequestration was awarded, upon which the debtor may apply to the Accountant in Bankruptcy for a certificate of discharge.<sup>310</sup>

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<sup>298</sup>Ibid.

<sup>299</sup>S 54 (3).

<sup>300</sup>S 5(1) of the Bankruptcy and Debt Advice (Scotland) Act 2014 inserts a new s 5 (2 ZA) (a) (i) of the Bankruptcy (Scotland) Act 1985.

<sup>301</sup>This will be a new s 5(2 ZA) (b) (i) and (ii) of the Bankruptcy (Scotland) Act 1985.

<sup>302</sup>Ibid s 5(2 ZA) (c).

<sup>303</sup>Ibid s 5 (2 ZA) (d).

<sup>304</sup>Ibid s 5 (2 ZA) (e).

<sup>305</sup>Ibid s 5 (2ZA) (f) of the Bankruptcy (Scotland) Act 1985.

<sup>306</sup>Ibid s 5 (2 ZA) (g) - (h). These apply where no award of sequestration has been made within those time frames.

<sup>307</sup>Ibid s 5 (2 ZB) (a).

<sup>308</sup>Ibid s 5 (2 ZB) (b).

<sup>309</sup>Ibid s 6 (1D) (b).

<sup>310</sup>Ibid s 54 C (1) - (2).

A new section 55A contains conditions attaching to a discharge in terms of section 54C. These include, for example, restrictions placed, for a period of six months after discharge, on a debtor obtaining credit and incurring debt and imposing an obligation on the debtor to inform persons that he has been given a discharge subject to such conditions.<sup>311</sup> Further, a new section 55B provides for sanctions, such as payment of a fine and imprisonment, to be applicable where the debtor does not comply with section 55A debt discharge conditions.

Thus it is evident that Scotland has made great strides in the right direction, in accordance with international insolvency principles by putting in place, and even improving upon, debt relief measures to accommodate LILA debtors who in many cases are victim of unforeseen and unfortunate circumstances.

### 3.5 Ireland

#### 3.5.1 Background

Major reform has recently been brought about in Ireland with the introduction of the Personal Insolvency Act of 2012 (PIA), with the objective, *inter alia*, of putting in place measures to alleviate over-indebtedness and to lessen its adverse consequences for economic activity in the state.<sup>312</sup> Previously, the bankruptcy procedure was strict and the law ‘failed to distinguish between the “can pay” and “won’t pay” debtors’.<sup>313</sup> Its failure to provide appropriate debt relief mechanisms for debtors prompted proposals for out of court processes, with easier access for debtors.<sup>314</sup> This is in line with Spooner’s<sup>315</sup> argument that the ‘law should provide open and uncomplicated access to debt relief procedures’. The PIA introduced significant changes to allow a debtor, who meets the debt relief entry requirements, to earn a ‘fresh start’.

In Ireland, debtors may enter into an informal voluntary arrangement with their creditors.<sup>316</sup> However, this would not be a practical option for LILA debtors, considering their financial position, as creditors would be unlikely to agree to this. The statutory debt settlement

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<sup>311</sup>See s 7 (2) of the Bankruptcy and Debt Advice (Scotland) Act 2014 which creates s 55 A (2) - (6).

<sup>312</sup>Preamble to the Personal Insolvency Act of 2012.

<sup>313</sup>Spooner (note 203 above) 292 footnote omitted.

<sup>314</sup>Law Reform Commission of Ireland, Consultation paper on Personal debt management and debt enforcement ¶¶3.317 (2009) available at [http://www.lawreform.ie/\\_fileupload/consultation%20papers/Consultation%20Paper%20on%20Personal%20Debt%20Management%20and%20Debt%20Enforcement\\_FINAL%20DRAFT.pdf](http://www.lawreform.ie/_fileupload/consultation%20papers/Consultation%20Paper%20on%20Personal%20Debt%20Management%20and%20Debt%20Enforcement_FINAL%20DRAFT.pdf) accessed on 1 September 2014.

<sup>315</sup>Spooner (note 201 above) 36.

<sup>316</sup>Spooner (note 203 above) 251.

mechanisms provided by the PIA are: bankruptcy; the Personal Insolvency Arrangement (PIA); the Debt Settlement Arrangement (DSA); and the Debt Relief Notice (DRN). The bankruptcy procedure is complicated, very public, and expensive – involving ‘lengthy High Court proceedings’ - creating insurmountable hurdles for a LILA debtor to obtain debt relief.<sup>317</sup> The PIA and DSA both make provision for schemes of arrangement whereby debtors enter into a binding agreement with creditors. The PIA is essentially for rearranging secured debts and DSA for unsecured debt. Both involve High Court supervision and are therefore complicated and expensive and not suitable for LILA debtors who do not have surplus income.<sup>318</sup> The debt relief notice (DRN),<sup>319</sup> which is strikingly similar to the debt relief order (DRO) in England and Wales, was designed specifically for debtors who have minimal assets and who are unable to pay their unsecured debts, ie, for LILA debtors. This debt relief measure will now be discussed.

### **3.5.2 Debt relief notice (DRN)**

This procedure is basically an administrative one, initiated by a debtor after submission of a written statement, which complies with section 27 (1) of the PIA, or by an intermediary<sup>320</sup> on the debtor’s behalf.<sup>321</sup> The application is made to the Insolvency Service.<sup>322</sup> A debtor is required to meet certain eligibility criteria in order to qualify for a DRN, including that the debtor:

- a) must have qualifying debts that amount to €20 000 or less;
- b) has net disposable income of €60 or less per month;
- c) has assets worth €400 or less;
- d) is domiciled in the state or within one year before the application date ordinarily resided in the state or had a place of business in the state; and
- e) has no likelihood of becoming solvent within the next period of 3 years.<sup>323</sup>

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<sup>317</sup>Ibid 249.

<sup>318</sup>Ibid 251.

<sup>319</sup>See Part 3 Chapter 1 of the PIA.

<sup>320</sup>In terms of section 25 of the PIA an intermediary is a person or class of person who is given authority by the Insolvency Service to execute the duties of an approved intermediary such as making application on behalf of a debtor as pointed out above.

<sup>321</sup>S 29 (1) of the PIA.

<sup>322</sup>S 29 (2) of the PIA.

<sup>323</sup>S 26 (2) of the PIA.

The procedure allows for exemption of certain assets the value of which should not exceed €6000.<sup>324</sup> The debtor is ineligible for the DRN in various specified instances including, for example, where the debtor is a party to, or has successfully completed within the period of 5 years before the application date, a DSA or a PIA or where a creditor has petitioned for the debtor's bankruptcy.<sup>325</sup>

### 3.5.3 Moratorium

During the running of the debt relief notice a moratorium is provided against any legal proceeding, judgment debt or any other enforcement procedure.<sup>326</sup> However, a creditor may bring such a proceeding, execution or other legal processes with leave of the court, where it deems this appropriate, and enforcement of criminal proceedings against the debtor is not restricted.<sup>327</sup> In cases where the debtor's situation changes positively, he or she is required to notify the Insolvency Service during the supervision period. This must occur, for instance, where his or her salary increases by €400 or more, or when he or she receives a gift worth €500, in which case 50 percent of that gift will be surrendered to the Insolvency Service.<sup>328</sup>

### 3.5.4 Debt discharge

The debt relief notice will lapse after a period of three years.<sup>329</sup> Although, in some cases, the supervision period may be extended.<sup>330</sup> Debt discharge has the effect of discharging all the specified qualifying debts, subject to certain exceptions,<sup>331</sup> and also the removal of the debtor's name from the Registrar of Debt Relief Notices.<sup>332</sup> Notably, Spooner<sup>333</sup> criticises the discharge period for being too long for a debtor who has no disposable income as well as no assets for liquidation, especially when compared to the one year period applicable in England and Wales under the debt relief order (DRO) procedure.

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<sup>324</sup>S 26 (6) (c) (1) of the PIA. These assets are comprised of household equipment, appliances for maintenance of a reasonable life by a debtor and his or her dependents, books, tools and other items of equipment used by him or her that are reasonably necessary in his or her employment, business or vocation.

<sup>325</sup>S 26 (8) of the PIA.

<sup>326</sup>S 35 of the PIA.

<sup>327</sup>S 35 (3) of the PIA.

<sup>328</sup>S 36 (2) of the PIA.

<sup>329</sup>S 34 (1) of the PIA.

<sup>330</sup>S 34 (2) of the PIA. It will be extended in instances where an investigation needs to be carried out, or for court consideration where an application has been lodged against discharge by an affected person or creditor.

<sup>331</sup>S 46 of the PIA. The exceptions are: interest; penalties; and other sums which have become due and payable.

<sup>332</sup>S 37 (2) of the PIA.

<sup>333</sup>Spooner (note 251 above) 761.

On 7 October 2014, the Insolvency Service Ireland, in an endeavour to facilitate debtors' 'getting back on track', announced a waiver of all fees for debtors applying, *inter alia*, for a DRN.<sup>334</sup> Thus it is evident that Ireland has incorporated internationally recognised debt relief norms into their system.

## 3.6 New Zealand

### 3.6.1 Background

The Insolvency Act 2006 (IANZ),<sup>335</sup> which came into effect in New Zealand in December 2007, provides for a bankruptcy process and three alternative debt relief mechanisms, namely, proposals for financial restructuring,<sup>336</sup> summary instalment orders,<sup>337</sup> and the 'no asset procedure' (NAP).<sup>338</sup> In terms of section 101 of the IANZ, the debtor's property vests in the Assignee at adjudication, but with the exclusion of certain property, in terms of section 158. The bankruptcy procedure is not suitable for a LILA debtor due, *inter alia*, to its duration and consequent restrictions.<sup>339</sup> A debtor's proposal, which must be court-approved, and also the summary instalment order, issued by the Assignee,<sup>340</sup> is not suitable for LILA debtors<sup>341</sup> on account of surplus income being necessary, for each procedure, for the debtor to make payments towards the debt. In the circumstances, similar arguments may be raised, as regards LILA debtors, as have been put forward in relation to the unsuitability of these procedures for 'no income no asset' (NINA) debtors who likewise have very little or no income to pay towards their debt, with the result that creditors are more likely to reject the proposal.<sup>342</sup> The NAP was specifically designed to accommodate a debtor with little surplus, or no, income.

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<sup>334</sup>See [http://www.isi.gov.ie/en/ISI/Press\\_Release\\_07\\_10\\_14.pdf/Files/Press\\_Release\\_07\\_10\\_14.pdf](http://www.isi.gov.ie/en/ISI/Press_Release_07_10_14.pdf/Files/Press_Release_07_10_14.pdf) available at [http://www.isi.gov.ie/en/ISI/Press\\_Release\\_07\\_10\\_14.pdf/Files/Press\\_Release\\_07\\_10\\_14.pdf](http://www.isi.gov.ie/en/ISI/Press_Release_07_10_14.pdf/Files/Press_Release_07_10_14.pdf) accessed on 6 December 2014.

<sup>335</sup>Public Act 2006 NO 55 (NZ).

<sup>336</sup>S 325 - 339.

<sup>337</sup>S 340 - 360.

<sup>338</sup>S 361 - 377B.

<sup>339</sup>M Josling 'Alternatives to bankruptcy' in Paul Heath and Michael Whale (eds) *Insolvency Law in New Zealand* Lexis Nexis (2011) 7; Coetzee and Roestoff (note 6 above) 204. See also T Keeper 'New Zealand's No Asset Procedure: A fresh start at no cost?' 14 *QUT Law Review* (2014) 79, 79.

<sup>340</sup>S 340. The summary instalment orders require a debtor to pay their debts in instalments (or otherwise) either in full or to the extent that the Assignee considers practical based on a particular case.

<sup>341</sup>S 331 - 333.

<sup>342</sup>D Brown 'The Financial Health Benefits of a Quick "NAP" New Zealand's Solution to Consumer Insolvency?' (INSOL Conference Academic Programme, Vancouver, June 2009) 8.

It may be noted that New Zealand provides a specific debt relief mechanism for NINA debtors in order to provide them with a ‘fresh start’.<sup>343</sup> As Josling explains:<sup>344</sup>

‘the basic policy behind this procedure is that the full bankruptcy process, with its duration, and consequential restrictions, is no longer appropriate to small debtors. These debtors, it is said, are typically always struggling to pay their debts, and are usually pushed into bankruptcy by some unfortunate event. In bankruptcy a dividend is ever hardly paid to creditors. Thus the justifications combine economic, humanitarian, and practical rationales.’

Thus the NAP merits discussed since it would accommodate LILA debtors whose income typically is able to cover only subsistence expenses.

### **3.6.2 The no asset procedure (NAP)**

The NAP has stringent entry requirements designed to prevent fraud.<sup>345</sup> Access to the NAP is limited to debtors who are not able to discharge payment towards their debt either ‘immediately or in the short or medium term’.<sup>346</sup> The criteria are that the debtor:<sup>347</sup>

- a) has no realisable assets;<sup>348</sup> and
- b) was not previously admitted to the no asset procedure; and
- c) has not previously been adjudicated bankrupt; and
- d) has total debts (not inclusive of any student loan balance) that are not less than \$1,000 and not more than \$40,000<sup>349</sup> and
- e) after undergoing a means test, is established not to have the means of repaying any amount towards his or her debt.<sup>350</sup>

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<sup>343</sup>Coetsee and Roestoff (note 6 above) 201; Keeper (note 339 above) 80.

<sup>344</sup>Josling (note 339 above).

<sup>345</sup>Coetsee and Roestoff (note 6 above) 204. See also D Brown and T GW Telfer *Personal and Corporate Insolvency Legislation: Guide and Commentary to the 2006 Amendments 2* ed LexisNexis NZ Limited (2013) 38; Keeper (note 339 above) 88.

<sup>346</sup>Even though the policy documents surrounding the NAP targeted on consumer debtors, this is not so based on the criteria set out in section 363 (1); see *ibid.* Brown and Telfer note that, instead of drawing a comparison between non consumer and consumer debtors, the ‘no asset procedure seeks to take a subset of debtors out of the bankruptcy procedure by screening for no asset debtors based on a number of listed criteria’; see D Brown and T GW Telfer (note 345 above) 39.

<sup>347</sup>S 363 (1) (a) - (e).

<sup>348</sup>See s 363 (2) in relation to which assets are included.

<sup>349</sup>S 363 (3) provides that these amounts are subject to variation by the Governor-General by order in Council to take account of increases in the all groups index of the Consumer Price Index.

In relation to the means test, Keeper<sup>351</sup> observes that ‘persons who are employed are often ineligible for NAP, because they are in a position to make on-going contributions towards their debt’. Kepper<sup>352</sup> further submits that ‘for this reason, NAP debtors predominantly are less likely to be employed than debtors under either of the alternative insolvency procedures’.

Nevertheless, a debtor is allowed to keep some assets, the maximum value of which will be determined by the Official Assignee, such as tools necessary for trade, household furniture and effects and a motor vehicle with a maximum value of \$5,000.<sup>353</sup> A debtor who qualifies for NAP, as prescribed by section 363 must complete and file with the Assignee an application and statement of affairs, both in the prescribed form.<sup>354</sup> The application may be accepted or rejected if the Assignee regards it as incorrect or incomplete<sup>355</sup> and a debtor may also be disqualified from the NAP in some instances.<sup>356</sup> After the debtor has applied to the Assignee, the Assignee must immediately send a summary of the debtor’s assets and liabilities to all the creditors of the debtor.<sup>357</sup> A debtor who has applied to get debt relief under the NAP is restricted from obtaining credit which exceeds \$100, even on hire purchase, either alone or jointly with another person, except where the debtor first informs the credit provider that he or she is under the NAP.<sup>358</sup> Admission to the NAP takes place when the Assignee sends written notice of this to the debtor.<sup>359</sup> Furthermore, the Assignee should notify creditors and advertise the debtor’s admission to the NAP in the prescribed manner.<sup>360</sup>

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<sup>350</sup>The prescribed means test is provided for in Insolvency (Personal insolvency) Regulations 2007, reg 65 and 66 read with reg 6. In terms of Regulation 66, the means test for the purposes of section 363 (1) (e) is whether, taking into account the income of the debtor personally and that of any relative with whom the debtor lives, the debtor has a surplus of money after paying the household’s usual and reasonable living expenses.

<sup>351</sup>Keeper (note 339 above) 90.

<sup>352</sup>Ibid.

<sup>353</sup>Insolvency and Trustee Service *The No Asset Procedure (NAP) and your assets* available at <http://www.insolvency.govt.nz/cms/financial-trouble/personal/step3/no-asset-procedure/what-happens-to-your-assets-when-you-enter-a-ntp> accessed on 11 November 2014.

<sup>354</sup>S 362 (1) and s 362 (2) (a)-(b). See also Insolvency (Personal Insolvency) Regulations 2007, reg 65.

<sup>355</sup>S 362 (3).

<sup>356</sup>S 364 (a) - (d). These instances are where the debtor conceals assets to deprive his or her creditors for example transferring property to a trust. Section 374 (1) provides that the Assignee may apply to the court to make an order of preservation of the debtors assets pending the application for the debtor’s adjudication where the debtor misled the Assignee or conceal assets. Furthermore, disqualification instances are such as where the debtor engages in conduct that is an offence under bankruptcy, debtor incurs a debt or debts where he or she has no means or repaying them back, where an application is lodged by a creditor for the debtor’s adjudication as bankrupt and a materially better outcome will be more likely for creditors than where the debtor is admitted to the no asset procedure.

<sup>357</sup>S 365.

<sup>358</sup>S 366.

<sup>359</sup>S 367 (1). See also Insolvency (Personal Insolvency) Regulations 2007, reg 67.

<sup>360</sup>S 367 (2). See also Insolvency (Personal Insolvency) Regulations 2007, reg 67.

A public register of debtors admitted to the NAP, and discharged from the NAP, will be kept by the Assignee.<sup>361</sup>

### 3.6.3 Moratorium and effect of the NAP

Entrance to the NAP by the debtor has the effect of prohibiting creditors from beginning or continuing any step to recover or enforce a debt which the debtor owes, or which may be provable if the debtor were to be adjudicated bankrupt.<sup>362</sup> However, there are certain debts that remain enforceable, such as those under a maintenance order in terms of the Family Proceedings Act 1980, child support amounts in terms of the Child Support Act 1991, and student loan balances.<sup>363</sup> Notably, Coetzee and Roestoff<sup>364</sup> point out a discrepancy regarding treatment of student loan balances between the NAP and the bankruptcy procedure: under bankruptcy they are dischargeable. A debtor has various duties under the NAP<sup>365</sup> and failure to abide by them may constitute an offence, as outlined in section 371 (1),<sup>366</sup> which may attract punishment by a fine or imprisonment.<sup>367</sup>

### 3.6.4 Debt discharge

Debt discharge takes place automatically after twelve months from the start date of admission to the NAP.<sup>368</sup> The discharge has the effect of cancelling all the debts subject to the NAP, as though they never existed. The debtor will not be liable to pay any interest or penalties that accrued during the period of the NAP.<sup>369</sup> Certain debts are non-dischargeable, such as debts resulting from fraud or fraudulent breach of trust.<sup>370</sup> The debtor is also liable to pay any

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<sup>361</sup>S 368 (1).

<sup>362</sup>S 369 (1) (a) - (b).

<sup>363</sup>S 369 (2).

<sup>364</sup>Coetzee and Roestoff (note 6 above) 205.

<sup>365</sup>S 370 (1) - (3). These duties are such as complying with a reasonable request from the Assignee, to provide assistance, documents, and necessary information to the Assignee. In instances where the debtor's circumstances change and he or she is able to repay an amount towards his or her debts referred to in s 369(1), he or she should notify the Assignee.

<sup>366</sup>These offences are, for example, where the debtor alone or jointly with another person obtains for the time being credit worth \$1,000 or more; incurs liability for the time being to any person of \$1,000 or more on behalf of another person; enters into a hire purchase agreement under which the debtor will be liable to pay \$1,000 or more. However, s 371 (2) (a) - (b) outlines defences, such as: where the debtor informs the creditor first before obtaining credit worth \$1,000 or more that the debtor is under the NAP; and where before incurring credit worth \$1,000 or more on behalf of another person the debtor informed the person giving the credit that he or she is under the NAP.

<sup>367</sup>S 371 (3).

<sup>368</sup>S 377 (1). However, in terms of s 377 (2) (a), discharge may be delayed in instances where termination is under consideration by the Assignee and where a deferral notice is sent to the debtor upon which the debtor will be discharged on the date specified in the deferral notice in terms of s 377 (6).

<sup>369</sup>S 377A (1).

<sup>370</sup>S 377A (2) (a) - (b).

penalties or interest in relation to the non-dischargeable debts.<sup>371</sup> It may be noted that Keeper<sup>372</sup> criticises the NAP on account of there being no debt education prerequisite for discharge. There are strong arguments to suggest that debt education may have the effect of ensuring that the debtor becomes a responsible and cautious borrower in the future.

### **3.7 Comparative remarks**

Drawing comparisons between the South African debt relief measures and foreign jurisdictions' debt relief mechanisms suitable for LILA debtors may be useful for establishing whether there is need to introduce a specific debt relief mechanism for LILA debtors in South Africa.

In the USA, Chapter 13 of the Bankruptcy Code, which provides for a repayment plan, is similar to debt review and debt re-arrangement, under the NCA, and the administration order, under the MCA. However, both the NCA and the MCA place restrictions on the type of debts and/or the amount of debt covered. The effect is to bar certain debtors, who do not fall in either of the categories, from obtaining debt relief. Debt review and debt re-arrangement and the administration order therefore in a measure provide relief to a LILA debtor who has either credit agreement debt or whose debt does not exceed the MCA's R50 000 monetary cap. Chapter 13 of the Bankruptcy Code affords debt discharge to a debtor -a feature which is not found under either debt review and debt re-arrangement or the administration order. Be that as it may, Chapter 13 of the Bankruptcy Code does not provide debt relief to a LILA debtor, and nor do debt review and debt re-arrangement or the administration order, because, typically, a LILA debtor does not have surplus income to contribute to a repayment plan.

In the USA, a LILA debtor is provided debt relief under Chapter 7 of the Bankruptcy Code, which is administrative in nature and for which the debtor has to meet a 'means test' in order to qualify. This minimises a debtor's costs towards getting debt relief and prevents abuse of the procedure. Chapter 7 of Bankruptcy Code is similar to sequestration in South Africa in that the debtor's assets are liquidated and the debtor ultimately obtains debt discharge. A debtor gets a 'fresh start', thus meeting the international norm. However, for a debtor to get debt relief under the sequestration procedure in South Africa he or she has to meet the 'advantage to creditors' requirement, which a LILA debtor will never be able meet.

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<sup>371</sup>S 377A (3).

<sup>372</sup>Keeper (note 339 above) 91.

In England and Wales, the bankruptcy procedure is comparable to the sequestration procedure in South Africa, although England and Wales do not have the strict requirement of ‘advantage to creditors’. There are also various options in terms of repayment plans, but, as discussed above, these are unsuitable for LILA debtors. Recognising this, the legislature introduced into the Insolvency Act 1986 a specific debt relief mechanism, the debt relief order (DRO), which is an extra-judicial procedure, ie, administrative in nature, and which imposes monetary thresholds to guard against abuse of the procedure, and provides debt relief, including a moratorium against actions by creditors, and debt discharge for qualifying debtors.

The sequestration procedure in Scotland is almost similar to the one in South Africa in the sense that a debtor surrenders his or her assets for liquidation, the proceeds of which are distributed to creditors. The entry requirements are not as strict as in South Africa as ‘advantage to creditors’ does not have to be established. The PTD and DAS in Scotland make provision for repayment plans but, as found in other jurisdictions already discussed, they do not specifically provide debt relief to a LILA debtor.

Therefore, Scotland enacted specific provisions, inserted into the Bankruptcy (Scotland) Act 1985, for a ‘Low Income, Low Asset’ route into bankruptcy, which is an extra-judicial procedure and which provides the debtor with a moratorium against debt enforcement by creditors as well as debt discharge. The Scottish legislature has taken further steps to enact new provisions for a new, ‘minimal asset’ procedure, which will replace the current LILA provisions in April 2015.

In Ireland, the bankruptcy procedure shares some similarities with the sequestration procedure in South Africa. The bankruptcy procedure involves High Court costs, a feature which is also found in the sequestration procedure in South Africa, which makes it impossible for a LILA debtor to get debt relief. The DSA and PIA are unsuitable for LILA debtors who typically do not have surplus income to apply in repayment plans. The debt relief notice (DRN) specifically provides for relief for LILA debtors and applies international policies and norms relating to debt discharge for a LILA debtor. The procedure is administrative in nature and thus enables a LILA debtor to access the mechanism in order to get debt relief. This position in Ireland is unlike that in South Africa where there is no specific mechanism for LILA debtors.

In New Zealand, the bankruptcy procedure shares some similarities with the South African sequestration order in that the debtor's assets are surrendered for the benefit of creditors. In New Zealand, the bankruptcy procedure has a monetary cap for debts that are applicable, unlike in South Africa where a debtor has to meet the 'advantage to creditors' requirement.

Proposals and summary instalment orders require a debtor to have surplus income in order to make repayments. This position is similar to that in terms of debt review and re-arrangement and the administration order, in South Africa, whereby a debtor makes some repayments towards a debt repayment plan. For similar reasons, expressed above, these are unsuitable for LILA debtors.

In New Zealand, the NAP process caters for LILA debtors, with a 'means test' that guards against abuse of the procedure, a moratorium against debt enforcement and debt discharge. It is conceivable that the 'means test' may have a negative impact on the accessibility of a LILA debtor to the NAP, as it was devised specifically for debtors with *no* income and *no* assets. However, it is unclear whether there is a need to address the debt issues of LILA debtors who may not be covered under the NAP process.

### **3.8 Conclusion**

It is important to note that the systems adopted in the foreign jurisdictions considered in this Chapter accommodate a LILA debtor. The debtor has to show some level of honesty when seeking debt relief. Spooner<sup>373</sup> submits that 'English law provides easy access to bankruptcy and a smooth procedural pathway to discharge'. None of the systems discussed require 'advantage to creditors'. Further, they do not contain overly strict entry requirements which would preclude an over-indebted LILA debtor from accessing debt relief. These foreign jurisdictions have adopted measures which are strikingly similar in a number of respects. For instance, a debtor has to satisfy certain criteria which guard against abuse of the system, and each provides a moratorium, prohibiting enforcement or debt recovery measures, and, lastly, a relatively easy and expeditious debt discharge, which enables a debtor to have a 'fresh start'. Thus the above discussed foreign jurisdictions have achieved with regards to debt discharge what is stated in the *World Bank Report* that 'the most effective form of relief from debt is a *fresh start*...'.<sup>374</sup>

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<sup>373</sup>Spooner (note 203 above) 250.

<sup>374</sup>*World Bank Report* (note 6 above) par 360.

The next will be a concluding chapter, which will draw together findings of the study and some recommendations.

## CHAPTER FOUR: CONCLUSION AND RECOMMENDATIONS

‘In a modern credit-driven society, debt relief is of outmost importance and it is thus apparent that the South African insolvency regime is in urgent need of reform. Equal relief should be provided to all insolvent and debt stressed individuals and the opportunity to obtain a statutory discharge should thus be afforded to all debtors, not only those who are able to prove an advantage to creditors. A proper alternative debt relief measure providing for a discharge of debt is thus of paramount importance.’<sup>375</sup>

### 4.1 Overview

In this chapter, material presented in Chapters Two and Three, on debt relief mechanisms in South Africa and the treatment of ‘low income low income’ (LILA) debtors in the selected foreign jurisdictions, will be summarised. Comparisons have been drawn between the position of LILA debtors in South Africa and in other jurisdictions in which specific mechanisms have been devised in order to provide LILA debtors with debt relief. This chapter will contain recommendations for the enactment of an appropriate debt relief mechanism for LILA debtors in South Africa.

### 4.2 Debt relief mechanisms in South Africa

In Chapter Two, the common law compromise and statutory mechanisms available to financially stressed debtors were set out, including, in terms of the Insolvency Act, the two sequestration procedures, namely, voluntary surrender and compulsory sequestration, the administration order, under the MCA, and also debt review and debt re-arrangement, under the NCA. It was shown that none of these is suitable for a LILA debtor.

Sequestration of a debtor’s estate entails liquidation of a debtor’s estate, the distribution of the proceeds amongst creditors and, ultimately, the debtor’s discharge from liability for pre-sequestration debt as a consequence of rehabilitation. However, in order for a debtor to obtain debt relief under the sequestration procedure, the ‘advantage to creditors’ requirement must be met.<sup>376</sup> This applies in both voluntary surrender, in which the debtor, and in compulsory sequestration (including friendly sequestration), where the applicant creditor, must prove that sequestration of a debtor’s estate will result in a pecuniary benefit to creditors. In the case of a LILA debtor with few assets and little income, it will be impossible for ‘advantage to

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<sup>375</sup>Boraine and Roestoff (note 184 above) 541.

<sup>376</sup>See 2.3.2 i) b).

creditors' to be established. In addition, the sequestration procedure is initiated by way of a High Court application. Thus, the procedure involves court costs and legal fees for representation. These features combined make the procedure expensive for a debtor with little income and insufficient assets with the effect that a LILA debtor will not be able to get debt relief via sequestration.<sup>377</sup>

The administration order may provide debt relief, to some extent, to a LILA debtor whose total debt falls below the monetary cap of R50 000. However, it should be noted that many LILA debtors may have incurred debt in excess of this amount. These LILA debtors will be excluded from getting debt relief through an administration order. Furthermore, application for an administration order must be made to the magistrate's court,<sup>378</sup> thus making the procedure expensive for a qualifying debtor to apply for debt relief. Further, because an administration order does not include *in futuro* debts,<sup>379</sup> a qualifying debtor has to discharge payment towards such debts in addition to the payments required in terms of an administration order that is issued. This has the effect of payment defaults by the debtor. Significantly, there is no limit to the duration of an administration order and the procedure does not have a debt discharge provision. Therefore, the effect is to keep the debtor under 'debt servitude' for a long time, which in some cases may extend to the debtor's life time. In addition, there is on-going abuse of the administration order.<sup>380</sup> The *lacunae* under the administration procedure, which have been exposed, as a whole have the effect of not providing appropriate debt relief to a LILA debtor.

Chapter Two also established that debt review and debt re-arrangement under the NCA does not provide adequate debt relief to LILA debtors. This was shown through the fact that the procedure covers 'credit agreements'<sup>381</sup> only. Therefore, although, at face value it can be said to provide relief to LILA debtors, closer scrutiny reveals that the procedure will not assist a LILA debtor in instances where the debts arise out of 'credit agreements'. This also means that a LILA debtor whose debts are a combination of 'credit agreement', and other types of, debt, may only be partially provided with debt relief under the NCA. What is more, as in the case of administration orders, there is no limit to the duration of the debt re-arrangement plan

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<sup>377</sup>See 2.3.1.

<sup>378</sup>See 2.4.2.

<sup>379</sup>See 2.4.5.

<sup>380</sup>Ibid.

<sup>381</sup>See 2.5.1.

and the procedure does not provide a debtor with debt discharge.<sup>382</sup> This, therefore, has the effect of making the debtor remain subject to the debt re-arrangement procedure for a long period of time that could extend to decades.

It is clear, from the requirements and procedures, that the South African debt relief legislative mechanisms target a particular type of debtor. The situation is that either a debtor qualifies for debt relief in respect of the sequestration procedure, administration order and the debt review and debt re-arrangement procedure, or he or she does not. It is an ‘all or nothing’ situation in which *lacunae* in the South African debt relief mechanisms have the effect of excluding LILA debtors from obtaining debt relief. These debtors are left at the mercy of creditors. The position in South Africa may be compared to that in the selected foreign jurisdictions where a LILA debtor has a specific debt relief mechanism at his or her disposal, which is followed by debt discharge.

#### **4.3. Debt relief mechanisms for LILA debtors in foreign jurisdictions**

In Chapter Three it was established that, in the USA, Chapter 7 of the Bankruptcy Code has the effect of providing adequate debt relief to a LILA debtor. In order to curb abuse of the procedure the debtor has to undergo a prescribed ‘means test’, which was introduced by the BAPCPA, which makes a determination of eligibility based on the debtor’s income level. The Chapter 7 bankruptcy procedure is inexpensive,<sup>383</sup> making it easier for a LILA debtor to file for debt relief. Debt counselling is also a pre-requisite before a debtor files for a Chapter 7 bankruptcy proceeding.<sup>384</sup> Upon acceptance to the procedure, a moratorium, referred to as an ‘automatic stay’, comes into effect which has the effect of protecting a debtor from enforcement by creditors.<sup>385</sup> Finally, a debtor gets an automatic debt discharge after the completion of the Chapter 7 bankruptcy procedure,<sup>386</sup> which enables him or her to have a ‘fresh start’. In cases of few assets the discharge takes place almost immediately and there is not always a liquidation sale, therefore the proceedings are completed within a short period of time.<sup>387</sup>

In England and Wales, the debt relief order (DRO) is especially included in the Insolvency Act 1986 as a mechanism to provide adequate debt relief to a LILA debtor. The eligibility

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<sup>382</sup>See 2.5.4.

<sup>383</sup>See 3.2.2.

<sup>384</sup>Ibid.

<sup>385</sup>See 3.2.3.

<sup>386</sup>See 3.2.4.

<sup>387</sup>Ibid. See also 3.2.2.

criterion to be met by a debtor is based on certain monetary value thresholds, which are that: the debtor's debt should not exceed £15,000; assets must be worth not more than £300; and the debtor's income should not exceed £50.<sup>388</sup> The procedure is administrative in nature, which involves an application for the debt relief order through an intermediary.<sup>389</sup> It is submitted that with an intermediary involved, the procedure is less expensive and more accessible to a LILA debtor because legal representation is not required. As soon as the debtor enters the DRO, a moratorium comes into place that bars actions against the debtor in relation to debts covered by the order.<sup>390</sup> Finally, a debtor gets a 'fresh start' through debt discharge, which takes place at the end of the one-year moratorium period.<sup>391</sup> Thus, the procedure provides appropriate debt relief to a LILA debtor in England and Wales.

The Bankruptcy (Scotland) Act 1985 provides for a specific 'Low Income, Low Asset' procedure, often referred to as the 'LILA route into bankruptcy'. A debtor who is not able to pay his or her debts as they fall due, and whose level of income and asset values qualifies him for access to this form of debt relief,<sup>392</sup> may make an application, which will be determined by the Accountant in Bankruptcy or the Sheriff.<sup>393</sup> The debtor gets a 'fresh start' through discharge which takes place after one year.<sup>394</sup> A new 'minimal asset procedure' recently received Royal Assent and will replace the LILA route into bankruptcy in April 2015. In terms of the new procedure, a debtor will have to undergo debt counselling first.<sup>395</sup> It also has set out debt<sup>396</sup> and asset value levels<sup>397</sup> for a debtor to qualify. Finally, the debtor will get debt discharge, and thus a 'fresh start' after a period of six months.<sup>398</sup>

In Ireland, the Personal Insolvency Act 2012, includes in its provisions the debt relief notice (DRN) in order to provide debt relief to a LILA debtor. The Act sets out debt, income and asset value thresholds, for a debtor to qualify for relief.<sup>399</sup> Further, the procedure is administrative in nature - application is done through an intermediary of the Insolvency

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<sup>388</sup>See 3.3.2.

<sup>389</sup>See 3.3.2.

<sup>390</sup>See 3.3.3.

<sup>391</sup>See 3.3.4.

<sup>392</sup>See 3.4.2.

<sup>393</sup>See 3.4.2.

<sup>394</sup>See 3.4.3.

<sup>395</sup>See 3.4.4.

<sup>396</sup>See 3.4.4.

<sup>397</sup>Ibid.

<sup>398</sup>Ibid.

<sup>399</sup>See 3.5.2.

Service.<sup>400</sup> This enables a LILA debtor to apply for relief since the procedure is inexpensive. Notably, all application fees have been waived, in Ireland, in order to assist debtors further.<sup>401</sup> A moratorium, which prohibits any action or proceeding, comes into place as soon the debtor is under the procedure.<sup>402</sup> Finally, a debtor gets debt discharge after a period of three years.<sup>403</sup> This has the effect of enabling a debtor to have a ‘fresh start’. Criticism has been levelled at the length of this period, with a suggestion that it should be reduced to one year, as in England and Wales.<sup>404</sup>

Finally, Chapter Three considered how LILA debtors are treated in New Zealand. The ‘No Assets Procedure’ (NAP) specifically provides debt relief to NINA debtors and, it is submitted, would apparently also be available to LILA debtors who have minimal surplus income to pay for anything besides basic necessities. If not, there may be a need to address the debt problem of LILA debtors in New Zealand, although this has apparently not been an issue. The NAP requires a debtor to undergo a ‘means test’, in order to qualify,<sup>405</sup> and application is made to the Official Assignee,<sup>406</sup> which therefore makes this (administrative) procedure inexpensive for a debtor since there are no court costs involved. A moratorium is provided for, which has the effect of staying any action or proceeding against the debtor.<sup>407</sup> Finally, a debtor gets a debt discharge after one year,<sup>408</sup> enabling a debtor to have a ‘fresh start’ - a common feature found in all the jurisdictions that were discussed in Chapter Three.

#### **4.4 Comparative Remarks**

It is important to note that a LILA debtor is offered a measure of debt relief in all the foreign jurisdictions that were discussed in Chapter Three. Therefore, the position of these debtors in foreign jurisdictions is unlike the position in South Africa where there is no appropriate debt relief mechanism for LILA debtors.

In the foreign jurisdictions that were discussed in Chapter Three, a LILA debtor has to meet the ‘means test’ or monetary, asset value thresholds and in some jurisdictions income value levels in order to get debt relief. This is unlike in South Africa where a debtor’s debt must not

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<sup>400</sup>Ibid.

<sup>401</sup>See 3.5.4.

<sup>402</sup>See 3.5.3.

<sup>403</sup>See 3.5.4.

<sup>404</sup>Ibid.

<sup>405</sup>See 3.6.2.

<sup>406</sup>See 3.6.2.

<sup>407</sup>See 3.6.3.

<sup>408</sup>See 3.6.4.

exceed R50 000 or a debtor must have debt arising out of credit agreements in order to get debt relief. Failure to meet these requirements means that a LILA debtor in South Africa has no any other debt relief mechanism at his or her disposal since sequestration is an insurmountable hurdle to a LILA debtor. These debtors are therefore left at the mercy of creditors. This therefore calls for this area of law to be reformed.

South Africa lacks an appropriate administrative debt relief procedure for LILA debtors as compared to the position of LILA debtors in some foreign jurisdictions. The discussed foreign jurisdictions provide debt relief mechanisms to a LILA debtor that are administrative in nature. An intermediary is involved in some jurisdictions. This therefore makes the procedure less expensive. This position is unlike in South Africa where the LILA debtor has to meet the High Court costs and legal representation in order to get debt relief under the sequestration procedure in terms of the Insolvency Act or magistrate's court costs for an administration order in terms of the MCA, or for debt review and debt re-arrangement under the NCA.

Debt discharge of a LILA debtor leading to a '*fresh start*' is a feature of all of the debt relief mechanisms in the foreign jurisdictions that were discussed in Chapter Three. It is an international norm that is not found in debt review and debt re-arrangement under the NCA or in the administration procedure under the MCA. The debt discharge of LILA debtors in the discussed foreign jurisdictions takes place within a short period of time except in Ireland where it takes place after three years. The three year period for discharge is facing criticism as discussed above. Thus these foreign jurisdictions with regard to debt discharge are in line with the INSOL International *Consumer Debt Report* which states:<sup>409</sup>

'In whatever form a discharge ultimately takes, debtors should have an opportunity to obtain relief from pre-existing indebtedness and to have a fresh start, free from their past financial obligations.'

#### **4.5 Recommendations**

Having advanced arguments which show the lack of appropriate debt relief mechanisms for LILA debtors in South Africa, study of the treatment of LILA debtors in foreign jurisdictions provides useful insights and guidance on ways to address the current position in this country. The following recommendations serve to provide for the way forward. The recommendations

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<sup>409</sup> *Consumer Debt Report* (note 203 above) 20.

call for a hybrid debt relief mechanism with features adopted from the foreign jurisdictions that were selected and discussed. The main mandate, or objective, should be to provide debt relief to a LILA debtor rather than a debt collection method for creditors; this may be supported by the submission advanced by Ramsay and Spooner<sup>410</sup> that ‘modern personal insolvency law is primarily about debtor relief rather than distribution of assets or investigation of an individual’s affairs’.

This dissertation calls for an out of court debt relief mechanism. It should be administrative in nature and therefore appropriate for LILA debtors, who have little income and few assets and are not a position to pay for High Court costs as well as legal representation. The *Consumer Debt Report* states that:<sup>411</sup>

‘extra-judicial or out-of-court proceeding take less of the courts’ time and of the judiciary, are less expensive and can be better designed for a more integrated approach to the problems the debtor is facing, which are more of a non-legal than of a legal nature.’

The *World Bank Report* further states that court costs are an accessibility obstacle to a low income and insufficient debtor to get debt relief.<sup>412</sup> The measure should therefore comprise an out of court process of debt settlement or re-arrangement facilitated by a statutorily bound intermediary, as seen in foreign jurisdictions. The procedure will therefore be inexpensive to a LILA debtor. Boraine and Roestoff<sup>413</sup> call for a less expensive informal debt relief measure for NINA debtors which will do away with the discrimination against these debtors at presently in South Africa.

The fact that the intermediary would be statutorily bound and regulated would have the effect of minimising abuse of office. Thus intermediaries should be qualified to do the job.<sup>414</sup> For instance, in cases where the intermediary is not bound, he or she might convert any surrendered income and assets for other purposes, as shown by the abuse taking place under the administration order in South Africa.<sup>415</sup> The intermediary’s costs should also be paid out

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<sup>410</sup>I Ramsay and J Spooner Insolvency proceedings: Debt relief orders and the bankruptcy petition limit a paper submitted to the Insolvency Service Call for Evidence October 2014 available at [http://www.academia.edu/8703184/Joint\\_Submission\\_with\\_Prof\\_Iain\\_Ramsay\\_to\\_Insolvency\\_Service\\_Call\\_for\\_Evidence\\_Debt\\_Relief\\_Order\\_access\\_conditions\\_and\\_creditor\\_bankruptcy\\_petitions](http://www.academia.edu/8703184/Joint_Submission_with_Prof_Iain_Ramsay_to_Insolvency_Service_Call_for_Evidence_Debt_Relief_Order_access_conditions_and_creditor_bankruptcy_petitions) accessed on 17 October 2014.

<sup>411</sup>*Consumer Debt Report* (note 203 above) 15.

<sup>412</sup>*World Bank Report* (note 6 above) par 300.

<sup>413</sup>Boraine and Roestoff (note 120 above) 546.

<sup>414</sup>*World Bank Report* (note 6 above) par 170.

<sup>415</sup>See 2.4.6.

of the surrendered income and assets in cases where the LILA debtor is in no position to pay for extra costs. This will enable that particular LILA debtor to apply for debt relief.

Measures guarding against abuse of the mechanism should be introduced in order to curb debtors, who have enough disposable income and sufficient assets, from accessing the process. The study calls for a ‘means test’ such as the one in USA under Chapter 7 of the Bankruptcy Code. The determination should be done based on whether a debtor’s income exceeds the poverty datum line. The ‘means test’ should be clear and must have the effect of accommodating every LILA debtor in South Africa but ensure that debtors with surplus income will not be able to abuse the proposed mechanism. Before a debtor gets debt relief it is proposed that a debtor should get debt counselling so that they will be responsible borrowers in the future.

During the tenure of the proposed mechanism it is proposed that a debtor should be provided with a moratorium against debt enforcement actions. Further, this will be in line with the *Consumer Debt Report* that a moratorium should be provided during the running tenure of the insolvency process.<sup>416</sup> This will ensure the smooth running of the mechanism.

Finally, upon the lapse of the debt relief mechanism it is proposed that a debtor should be afforded a debt discharge. This serves two purposes: to permit a LILA debtor to become an active member of the economy; and to boost the economy through having active members. As Spooner<sup>417</sup> puts it, the ‘fresh start’, a common phenomenon in modern insolvency law,

‘aims to free debtors from the burden of lifelong indebtedness in order to achieve increased economic productivity and entrepreneurship, as well as to serve social justice aims and humanitarian goals.’

The debtor will therefore get a ‘fresh start’, a common feature which is achieved in all of the foreign jurisdictions that were discussed in this dissertation. Thus, South Africa will be on a par with other countries in this regard. In respect of poor debtors, discharge should take place immediately as is seen in the USA.<sup>418</sup>

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<sup>416</sup>*Consumer Debt Report* (note 203 above) 17.

<sup>417</sup>Spooner (note 251 above) 763.

<sup>418</sup>Reference to some countries which grants discharge within a short period to poor debtors is also made in the INSOL International *Consumer Debt Report* 2011 18.

## 4.6 Conclusion

The South African debt relief mechanisms lack an appropriate out of court procedure that is accessible to a LILA debtor. The various entry requirements for each available mechanism determine who may and who may not get debt relief. These all exclude LILA debtors and, ironically - and tragically - these are debtors who need debt relief the most. This has the effect of leaving the LILA debtors to the wrath of creditors. Although the sequestration procedure does at least provide debt discharge, upon rehabilitation in terms of the Insolvency Act 1936, and therefore a 'fresh start', a LILA debtor will never be able to meet the 'advantage to creditors' requirement or meet High Court costs. Administration orders, under the MCA, and debt review and debt re-arrangement, under the NCA, endure until the debtor has paid all debts in full and there is no statutory limit imposed on the time period for payment of debts by the debtor. This will result in the debtor paying their debts for a long time, which may extend to their entire lifetime.

This 'all or nothing' situation must end and a solution for LILA debtors should be found. It is proposed that a mechanism should be devised – a hybrid of the various features found in specific LILA debt relief provisions internationally. It should be an out of court procedure, with application being made to a statutorily regulated intermediary. The process should be of limited duration, with a moratorium imposed against actions by creditors and debt discharge, in order to provide a LILA debtor with a 'fresh start'. This would afford a LILA debtor with an appropriate debt relief option and accord to a LILA debtor the same treatment as other debtors in South Africa. Thus the South African insolvency system will be in line with proposals made in the INSOL International *Consumer Debt Report* that 'legislators should enact laws to provide for a fair and equitable, efficient and cost effective, accessible and transparent settlement and discharge of consumer...debts'.<sup>419</sup>

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<sup>419</sup>*Consumer Debt Report* (note 203 above) 13.

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