

**A comment on debt relief options for insolvent consumer debtors  
in South Africa**

**by**

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## **ABSTRACT**

The paper will be focused on examining the debt relief options available for consumer debtors in South Africa. This paper will look at the relationship between the National Credit Act 34 of 2005 and the Insolvency Act 24 of 1936. Further, it will examine the relationship between the provisions of section 74 of the Magistrates' Courts Act 32 of 1944. The paper will conclude by looking at debt relief options available for consumer debtors in the United States of America and in England and Wales and will make comparative comments and recommendations on how we can adopt some provisions into our own insolvency system.

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# CHAPTER ONE

## INTRODUCTION

‘The only man who sticks closer to you in adversity than a friend is a creditor’

Unknown

### 1.1 Background

Consumer insolvency and over-indebtedness are serious issues that affect most South African consumers. Therefore, it is imperative that our insolvency law is reformed appropriately in order to effectively address these issues. It is important, for a society like ours, to have a legal system which takes cognisance of the lived reality of consumer debtors in South Africa and the challenges they face. The South African legal system offers a variety of what may be regarded as ‘debt relief options’ for insolvent and over-indebted consumer debtors. These include sequestration, debt review and an administration order. Sequestration, which is provided for by the Insolvency Act 24 of 1936 (hereafter referred to as ‘the Insolvency Act’ or ‘the Act’, where appropriate), regulates, amongst other things, the insolvency of natural persons. The other two debt relief options available are debt review, with possible debt rearrangement, provided for by the National Credit Act 34 of 2005 (hereafter referred to as ‘the NCA’), and administration orders, provided for by the Magistrates’ Courts Act 32 of 1944 (hereafter referred to as ‘the MCA’). Commentators have observed that the South African legislature has been slow in following the international trend of having a consumer insolvency system which balances appropriately the interests of both creditors and debtors.<sup>1</sup>

All three of the abovementioned debt relief options apparently present either a procedural or substantive problem and, as a result, they have failed to offer consumer debtors adequate debt relief. The major shortcoming of debt relief by sequestration is the requirement of proof of ‘advantage to creditors’ without which a court cannot consider exercising its discretion whether or not to grant a sequestration order.<sup>2</sup> Therefore, it is not available as a debt relief option for debtors where it is not proved that sequestration of their estates would give rise to an advantage for their creditors. Thus, it may be said that ‘poor’ debtors, as opposed to ‘affluent’ ones, who cannot access the sequestration mechanism provided by the Insolvency

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<sup>1</sup> Coetzee and Roestoff ‘Consumer debt relief in South Africa – should the insolvency system provide for NINA debtors? Lessons from New Zealand’ (2013) 22 *International Insolvency Review* 188-210,188.

<sup>2</sup> Boraine and Roestoff ‘Vriendskaplike sekwestrasies – ‘n produk van verouderde beginsels?’ (Deel 1) 1993 *De Jure* 229, 235-241.

Act due to lack of proof of ‘advantage to creditors’, will, as a consequence, forever be indebted to their creditors, with no prospect of rehabilitation in terms of the Insolvency Act and the resultant discharge from liability for pre-sequestration debt which it also provides.<sup>3</sup>

A debtor, who cannot satisfy the stringent requirements of the Insolvency Act, is left with two other potential debt relief options, namely, debt review and rearrangement or an administration order, as mentioned above. However, these options also have inherent problems, which will be discussed below. The biggest challenge facing a debtor, who elects to utilise either of these debt relief options, is the fact that his estate is not protected from being sequestrated by his creditors. The provisions for debt review, contained in the NCA, do not bar a creditor from applying for the sequestration of the estate of a debtor who has applied for or is subject to debt review. Boraine and Roestoff have pointed out that this position in our law results in debtors being unable to choose how to deal with their financial dilemma.<sup>4</sup> Concerns have been expressed that this does not conform to the international principles which advocate providing a debtor with the choice of a form of debt relief which poses an alternative to liquidation of his assets.<sup>5</sup>

On the other hand, the NCA’s mechanisms for debt review and debt rearrangement require an over-burdened debtor to have some income from which to make regular payments in terms of a payment plan. Therefore, debtors with no income will not derive any benefit from debt review. The same may be said in respect of administration orders, in terms of the MCA. This accentuates the unfortunate position in our law that debtors in South Africa who are too poor to enter the insolvency regime via sequestration are left with no alternative recourse to debt relief. Therefore, legislative intervention is required in order to enact appropriate statutory provisions which will address the needs of debtors with no income and no assets.

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<sup>3</sup> S 127A of the Insolvency Act, See also Steyn, ‘Statutory regulation of the forced sale of home in South Africa’ LLD thesis, University of Pretoria 2012, 354. See also Boraine and Roestoff, ‘Revisiting the state of consumer insolvency in South Africa after 20 years: The court’s approach, international guidelines and an appeal for urgent law reform’ (Part 1) 2014 (77) *THRHR* 356, where it was noted that ‘the requirement of advantage to creditor is fundamental to the South African Insolvency Act and the Act actually places a stumbling block in a way of debtors wishing to use it as a form of debt relief.

<sup>4</sup> Boraine and 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) 109 20.

<sup>5</sup> Steyn ‘Sink or Swim? Debt review’s ambivalent “lifeline” - A second sequel to “... a tale of two Judgments” *Nedbank v Andrews and another* (240/2011) [2011] ZAECPEHC 29 (10 May 2011); *FirstRand Bank Ltd v Evans* 2011 4 597 (KZD) and *FirstRand Bank Ltd v Janse van* 2012 2 All SA 186 (ECP) 2012 (15)4 *PELJ* 189, 217.

Commentators in this area have long maintained that the debt relief options in South Africa are inadequate and they therefore call for an overhaul of the consumer insolvency system.<sup>6</sup> Boraine and Van Heerden submitted that the legislator, when enacting new legislation, does not always consider its effects on existing legislation, with the result that it is left to the courts to consider its impact and application.<sup>7</sup> The courts have been asked to pronounce on the effect of the provisions of the NCA and their interaction with the Insolvency Act in several cases and more recently in the case of *FirstRand Bank v Kona and another*.<sup>8</sup> However, as will be submitted below, following specific discussion of these decisions, these judgments have not provided appropriate solutions to afford adequate debt relief options for consumer debtors in South Africa. In an attempt to resolve conflicts that emerged from these judgments, the legislature has recently introduced a new section 8A into the Insolvency Act.<sup>9</sup> Section 8A provides that – ‘a debtor who has applied for a debt review must not be regarded as having committed an act of insolvency.’ This was one of the reasons that prompted the Constitutional Court to decline, in the recent case of *De Klerk v Griekwaland Wes Korporatief Bpk*<sup>10</sup> (*‘De Klerk’*) to specifically address and resolve the issue. However, the wording of the new section 8A appears to be inadequate and there is doubt whether this section will be the solution as envisaged by the Constitutional Court in the case of *De Klerk*.

Comparative study, including consumer insolvency and consumer credit laws of the United States of America and England and Wales, indicate that these countries adopt a more debtor-friendly approach, providing more appropriate debt relief for individuals. It also suggests that South Africa’s consumer insolvency laws have not shifted to meet the internationally accepted standards of providing a system that balances the interests of creditors and debtors. In this paper, statutory mechanisms which potentially provide debt relief options for overburdened consumer debtors, as well as various associated problems, will be discussed. In light of debt relief options which are available in the United States of America and England and Wales, consideration will be given to whether the South African legislature should adopt any similar mechanisms into our system.

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<sup>6</sup> Boraine and Roestoff (note 4 above) 24.

<sup>7</sup> Boraine and Van Heerden ‘To sequester or not to sequester in view of the National Credit Act 34 of 2005: A tale of two judgments’ 2010 (13) *PELJ* 84 -508, 85.

<sup>8</sup> *FirstRand Bank v Kona and another* 2003/2014 [2015] ZSCA 11; *Ex parte Ford and two similar cases* 2009 (3) SA 376; *Investec Bank Ltd and Another v Mutemeri* 2010 (1) SA 265 (GSJ); *Naidoo v ABSA Bank Ltd* 2010 (4) SA 597 (SCA); *FirstRand Bank Ltd v Evan* 2011 (4) SA 597 (KZD) and *FirstRand Bank Ltd v Janse van Rensburg* [2012] 2 All SA 186.

<sup>9</sup> This was section 38 of, read with the schedule to, the National Credit Amendment Act 19 of 2014.

<sup>10</sup> (CCT 187/13) [2014 ZACC 20] (19 June 2014).

## **1.2 Research Statement**

The increased ease of access to credit has led to increased over-indebtedness, however, the current South African legal system appears to lack adequate debt relief options to address this concerning issue of over-indebtedness.<sup>11</sup> Therefore, there appears to be need for a system of law that will provide effective debt relief options for consumer debtors who find themselves in financial difficulties.<sup>12</sup> One way in which this can be achieved is by enacting legislation which will balance both the interests of creditors and debtors and by doing so provide adequate debt relief options for over-indebted consumers.

## **1.3 Research Questions**

This paper seeks to address and answer the following questions.

- Does South Africa's legal system offer adequate debt relief options for its insolvent consumer debtors?
- What are the current debt relief options and the issues associated with each?
- How have other jurisdictions, particularly the United States of America and England and Wales addressed this issue?
- What, from these jurisdictions, might be adopted and incorporated in our system?

## **1.4 Research objectives**

The objectives of this paper are to consider the various debt relief options available to individual debtors in South Africa and the problems associated with them. Further, the aim is to compare statutory provisions applicable in selected foreign jurisdictions with a view to making recommendations regarding possible legislative reform in South Africa.

## **1.5 Delineations and limitations**

It will not be feasible in such a short dissertation to present any in depth analysis of the law, and its application, regulating sequestration, debt review and re-arrangement and administration orders. Discussion of each will therefore be restricted to basic principles pertaining to them and to selected aspects, and problems arising in respect, of each, as appropriate, given the objectives of this paper.

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<sup>11</sup> Boraine and Roestoff (note 4 above) 2.

<sup>12</sup> Steyn (note above 5) 220.

## **1.6 Terminology**

For the sake of convenience, unless specifically indicated otherwise, ‘he’ will be used to reflect ‘he or she’ and ‘his’ will be used to reflect ‘his or her’. In this dissertation, particularly in the discussion of the law in foreign jurisdictions, the terms ‘insolvency’ and ‘bankruptcy’ will be used interchangeably.<sup>13</sup> In relation to the NCA ‘debt re-arrangement’ and ‘debt restructuring’ are used interchangeably.<sup>14</sup>

## **1.7 Overview of chapters**

This dissertation is divided into seven chapters, including this introductory chapter. Chapter 2 discusses sequestration, in terms of the Insolvency Act, and identifies certain problems associated with sequestration of a debtor’s estate as a form of debt relief. Chapter 3 focuses on administration orders and the associated problems. Chapter 4 discusses the NCA and some problematic issues which have arisen in relation to debt review and debt re-arrangement. Chapter 5 outlines the interface between sequestration, provided for by the Insolvency Act, and provisions regulating debt review and debt re-arrangement, contained in the NCA. Chapter 6 consists of a comparative study aimed at identifying statutory provisions in other jurisdictions which might appropriately be adopted in South Africa to reform our consumer insolvency legal system. Chapter 7 contains conclusions and recommendations in support of the oft-made call for legislative intervention in South Africa.

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<sup>13</sup> Fletcher, *Law of Insolvency* 4<sup>th</sup> edition (2009) Sweet and Maxwell 6-7.

<sup>14</sup> Vessio, ‘Beware of the provider of reckless credit’ 2009 *TSAR* 274-289, 284.

## CHAPTER TWO

### SEQUESTRATION IN TERMS OF THE INSOLVENCY ACT 24 OF 1936

#### 2.1 General

South African insolvency law is regulated mainly by the Insolvency Act 24 of 1936 and, where the Act is silent on an issue and no other statute specifically applies, by the common law. The Insolvency Act does not define the term insolvency; it is only in case law that we find this definition. The test for insolvency, established in *Venter v Venter*, is ‘whether the debtor’s liabilities fairly estimated exceed his assets fairly valued.’<sup>15</sup>

South African insolvency law is neither Roman Dutch, nor purely English, law, its legal tradition having been influenced, both in substance and methodology, during the periods of Dutch and British colonial domination in the Cape of Good Hope.<sup>16</sup> The South African Law Reform Commission (hereafter referred to as ‘the Commission’), as early as the late 1980s, embarked on an extensive review of South African insolvency law which ultimately led to a recommendation for the substitution of the Insolvency Act with a proposed unified Act.<sup>17</sup> It has been stated that it is clear, from the changes and recommendations proposed by the Commission, that no substantial policy-driven or empirical investigation in respect of regulation of South African insolvency law had been undertaken before then. Further, the Commission’s recommendations have not yet been implemented and, as a result, the South African law regulating the position, as regards the insolvency of natural persons, has remained largely unchanged since 1936.<sup>18</sup>

For a proper understanding of the concept of sequestration as a potential form of debt relief for an insolvent person, it is useful to appreciate the philosophy behind the South African law of insolvency and it is necessary to know the basic principles underlying the rights of debtors and creditors in South Africa in general.<sup>19</sup> When a debtor is unable to fulfil his obligations,

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<sup>15</sup> 1973 (3) SA 175(T) 179.

<sup>16</sup> Calitz ‘Historical overview of state regulation of South African insolvency law’ (2010) 16 (2) *Fundamina* 1-27, 1.

<sup>17</sup> Calitz (note 16 above) 1.

<sup>18</sup> Calitz (note 16 above) 1. See also Evans ‘The abuse of the process of the court in friendly sequestration proceedings in South Africa, *International Insolvency Review*, volume 11 (2002) 13-34, 31. See also Boraine and Roestoff 2014 *THRHR* (note 3 above) 352, where they state that South Africa still has an Insolvency Act that hails from 1936, which has not moved with the times and still remains pro creditor where only the privileged debtors, who are able to prove ‘advantage to creditors’ will be entitled to rehabilitation.

<sup>19</sup> E Bertelsmann *et al Mars*, *The Law of Insolvency in South Africa* 9<sup>th</sup> edition (2008) Juta & Co 1.

various procedures are available to both the debtor and creditors.<sup>20</sup> These procedures include a creditor demanding payment, issuing summons and obtaining a civil judgment against the debtor, issued through the official court process applicable to debt enforcement.<sup>21</sup> A civil judgment would make it possible for the judgment creditor to execute against the assets of the debtor in order to obtain satisfaction of the judgment debt. It would also be open to the debtor himself voluntarily to surrender his estate by bringing an application to the high court,<sup>22</sup> in terms of the Insolvency Act, for the issue of a sequestration order, the consequence of which would be the liquidation of all of his non-exempt assets and the distribution of the proceeds to his creditors in accordance with the provisions of the Insolvency Act. On the other hand, one or more of the creditors may apply to the high court, in terms of the Insolvency Act, to have the debtor's estate sequestered.<sup>23</sup>

One of the consequences of sequestration is that it precludes creditors from bringing, or continuing, any action against the insolvent to enforce the payment of debts. Another is that, ultimately, rehabilitation of the insolvent gives rise to a discharge for him of liability for all pre-sequestration debt. In these respects, sequestration may be regarded, from the perspective of the debtor, as a debt relief mechanism. However, it should be borne in mind that, when the Insolvency Act was enacted, in 1936, the primary intention of the legislature was not to devise a debt relief mechanism for the benefit of the debtor, but the main theme which runs through the Act is one aimed at ensuring the greatest pecuniary advantage for creditors.<sup>24</sup> Further, even when these requirements have been met, the granting of the order remains in the discretion of the court.<sup>25</sup>

It is for these reasons that South Africa's personal insolvency law is known for its strongly creditor-oriented approach as opposed to the insolvency laws of countries such as England and the United States of America which have a more debtor- friendly approach.<sup>26</sup>

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<sup>20</sup> Mars, *The Law of Insolvency* (note 19 above) 1.

<sup>21</sup> Where the debt arose out of a credit agreement, the provisions of the NCA will also have to be complied with.

<sup>22</sup> It is only a high court that can make a sequestration order as this affects a person's status.

<sup>23</sup> Mars, *The Law of Insolvency* (note 19 above) 16-17; Calitz (note 16 above) 13.

<sup>24</sup> Smith, 'The Recurrent Motif of the Insolvency Act – Advantage for creditors' (1985) 7 *Modern Business Law* 27.

<sup>25</sup> See ss 6, 10 and 12 of the Insolvency Act.

<sup>26</sup> Roestoff and Coetzee 'Consumer Debt Relief in SA; Lessons from America and England; and suggestions for the way forward' (2012) 24 *Merc LJ* 53-76, 54. See also Evans, 'A brief explanation of consumer bankruptcy and aspects of the bankruptcy estate in the United States of America' 2010 XLIII *CILSA* 337-351,337.

In this chapter, pertinent aspects of the procedure by which a debtor's estate may be sequestrated in terms of the Insolvency Act, i.e., by voluntary surrender or by compulsory sequestration, will be discussed briefly, as well as the requirements for a sequestration order to be issued and some of the consequences of sequestration. It will also identify and briefly discuss problems which arise within the context of the conception of sequestration as a potential means by which a debtor may obtain debt relief.

## **2.2 Sequestration: procedure; requirements and related issues**

### **2.2.1 Two procedures: voluntary surrender and compulsory sequestration**

Sequestration applications may be brought in the high court either by the debtor on an *ex parte* basis through voluntary surrender, or by way of compulsory sequestration in an application with prior notice by a creditor.<sup>27</sup>

Section 6 of the Insolvency Act provides that in a voluntary surrender the debtor must satisfy the court that:

- a. he has complied with all the statutory formalities required in section 4 of the Act;
- b. he is factually insolvent;
- c. sequestration will be to the advantage of creditors; and
- d. the free residue is sufficient to cover the costs of sequestration.<sup>28</sup>

In *Ex Parte Bergh*,<sup>29</sup> Centlivres J stated that 'the two major requirements in a voluntary surrender are that there must be sufficient reasonable assets to defray the costs of sequestration and that the surrender will be to the advantage of creditors.'<sup>30</sup> Therefore, if there are insufficient assets to pay all of the costs of sequestration, out of the realisable property, the court cannot accept the surrender.<sup>31</sup> It may also be noted that, even where the requirements have been met, the court has the discretion whether to grant or refuse the sequestration order.<sup>32</sup>

On the other hand, for compulsory sequestration, the applicant creditor must show that:

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<sup>27</sup> Ss 3, 6, 10 and 12 of the Insolvency Act. See also Mars (note 19 above) 1.

<sup>28</sup> S 6 of the Insolvency Act.

<sup>29</sup> 1928 OPD 220 132.

<sup>30</sup> *Ex parte Bergh* 132.

<sup>31</sup> *Ex parte Bergh* 132.

<sup>32</sup> S 6 (1) of the Insolvency Act.

- a. he has established a claim which entitles him, in terms of section 9(1), to apply for sequestration of the debtor's estate;
- b. he has a liquidated claim of at least R100 or, where more creditors with separate claims apply jointly, that the total of their claims in aggregate is not less than R200;
- c. the debtor is actually insolvent or has committed an act of insolvency; and
- d. there is reason to believe that sequestration will be to the advantage of creditors.<sup>33</sup>

For a creditor to succeed in a compulsory sequestration, he must obtain a provisional and a final sequestration order. At the initial stage, the applicant creditor must establish evidence which leads the court to form the opinion that *prima facie* the abovementioned requirements have been met and, if they are, the court has the discretion to make an order sequestrating the estate of the debtor provisionally.<sup>34</sup> Before the court may grant a final order of sequestration, it must be *satisfied* as to the above requirements.<sup>35</sup> Even where the requirements are met, the court has the discretion whether or not to grant a final order of sequestration.

### 2.2.2 Advantage to creditors

The Insolvency Act requires proof that sequestration will be to the ‘advantage of creditors’ and yet it does not provide a definition for this phrase. It has been left to the judiciary to interpret it and to provide the meaning of it, which, as it appears, is not clear cut. In *Hillhouse v Stott; Freban Investments (Pty) Ltd v Itzkin; Botha v Botha* (‘*Hillhouse*’),<sup>36</sup> the court held that every case must be judged on its own facts and the discretion of the court to judge each case on such facts must remain unfettered.<sup>37</sup> According to the cases, and as pointed out by Boraine and Van Heerden, in deciding whether the advantage to creditors requirement is met, the inquiry is whether a substantial portion of the creditors, which is determined according to the value of their claims, will derive advantage from sequestration.<sup>38</sup> It is required that sequestration at least yields a non-negligible dividend.<sup>39</sup> If, after the costs of sequestration

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<sup>33</sup> Ss 10 and 12 of the Insolvency Act.

<sup>34</sup> S 10 of the Insolvency Act.

<sup>35</sup> S 12 of the Insolvency Act; *Amod v Khan* 1974 (1) SA 150.

<sup>36</sup> 1990 (4) SA 580 (W).

<sup>37</sup> *Hillhouse v Scott*. See also Van Heerden and Boraine ‘The interaction between the debt relief measures in the National Credit Act 34 of 2005 and aspects of Insolvency Law’ (2009) 12 (3) *PELJ* 22-161, where they state that one would nevertheless hope that, when exercising their discretion in sequestration applications, courts will follow a common-sense approach by considering the best possible solution in every instance.

<sup>38</sup> Boraine and Van Heerden (note 7 above) 89.

<sup>39</sup> Boraine and Van Heerden (note 7 above) 89.

have been met, there would be no, or only a negligible, payment to creditors, such advantage is not present.<sup>40</sup>

Despite courts consistently having been reluctant to stipulate a minimum anticipated dividend to be required,<sup>41</sup> more recently, in *Ex Parte Ogunlaja and others* ('Ogunlaja'),<sup>42</sup> a prospective dividend of 20 cents in the rand was regarded as the minimum benefit that would have to be established before an application for surrender of an estate or for compulsory sequestration would be granted.<sup>43</sup> In *Ex Parte Cloete*,<sup>44</sup> the Free State High Court took the view that it should follow the guidelines laid down by the North Gauteng High Court in this regard.<sup>45</sup>

Because, in cases of compulsory sequestration, the applicant creditor often lacks access to information regarding the debtor's financial position, as indicated above,<sup>46</sup> a lesser onus is placed on the creditor.<sup>47</sup> In *Meskin & Co v Friedman* ('Meskin'),<sup>48</sup> Roper J stated that 'the phrase 'reason to believe', used as it is in both these sections (sections 10 and 12 of the Insolvency Act), indicates that it is not necessary, either at the first or at the final hearing, for the creditor to induce in the mind of the court a positive view that sequestration will be to the financial advantage of creditors'.<sup>49</sup> As was held in *Meskin* the facts put before the court must satisfy it that there is a reasonable prospect, not necessarily likelihood, but a prospect which is not too remote that some pecuniary benefit will result to creditors.<sup>50</sup> Further, courts have held that it is not necessary to prove that the insolvent has any assets but the fact that there are reasons for thinking that as a result of an enquiry under the Act, some may be revealed or recovered for the benefit of the creditors is sufficient.<sup>51</sup>

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<sup>40</sup> Boraine and Van Heerden (note 7 above) 89. See also Van Heerden and Boraine, (note 37) 88, where they submitted that 'an advantage to creditors is about more than just a monetary dividend and is essentially a *de facto* test that has to be determined with reference to the peculiar circumstances of each case'.

<sup>41</sup> 1996 (1) SA 935 (C).

<sup>42</sup> 2011 JOL 27029 (GNP).

<sup>43</sup> *Ex parte Ogunlaja* par 23.

<sup>44</sup> (1097/2013) [2013] ZAFSHC 45 (5 April 2013).

<sup>45</sup> *Ex parte Cloete* par 23.

<sup>46</sup> See 2.2.1 for the requirements for compulsory sequestration.

<sup>47</sup> Boraine and Van Heerden (note 7 above) 114.

<sup>48</sup> 1948 (2) SA 555 (W) 559.

<sup>49</sup> *Meskin* par 558.

<sup>50</sup> *Meskin* par 559.

<sup>51</sup> *Meskin* par 559.

In *Ex parte Shmukler-Tshiko and others*<sup>52</sup> ('*Shmukler*') the court noted that the administration costs of the applications reduced the amount available for distribution amongst concurrent creditors and, as a result, undermined the purpose of a sequestration, which is that it should be to the advantage of creditors.<sup>53</sup> Further, the court noted that, more often than not, the costs of sequestration exceeded the amount available to concurrent creditors and consequently it appeared that the sequestration advantaged administrators rather than creditors.<sup>54</sup> The court held that it was trite law that an advantage to creditors was a broad concept ranging from 'non-negligible pecuniary benefit' through to an enquiry into a debtor's financial affairs. The court also warned that an act of insolvency was insufficient reason on its own for the belief that the sequestration of the debtor's estate will be to creditors' advantage.<sup>55</sup>

In light of the above requirements, it is clear that there is a greater burden of proof required in a voluntary surrender than for compulsory sequestration. The degree of proving advantage to creditors in compulsory sequestration is lighter due to the wording of sections 10 (c) and 12 (1) (c) as compared with that in section 6.<sup>56</sup>

### **2.2.3 'Acts of insolvency'**

A creditor may have good reason for believing that a debtor is insolvent but may not be in a position to prove it.<sup>57</sup> The legislature catered for this by designating, in section 8 of the Insolvency Act, certain acts or omissions by a debtor as 'acts of insolvency'. As indicated above,<sup>58</sup> if the creditor, in an application for compulsory sequestration, can establish that the debtor has committed one or more of these 'acts' he may be able to apply for, and obtain, a sequestration order without proving actual insolvency on the part of the debtor.<sup>59</sup>

Of particular relevance to this paper is the act of insolvency created by section 8 (g), which provides that a debtor commits an act of insolvency if he gives notice in writing to any one of his creditors that he is unable to pay any of his debts.<sup>60</sup> The notice must convey inability to pay as opposed to mere unwillingness to pay. The test applied, to determine whether this act

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<sup>52</sup> 2012 SA (GSJ) decided 26 October 2012.

<sup>53</sup> *Shmukler* par 31.

<sup>54</sup> *Shmukler* par 32.

<sup>55</sup> *Shmukler* par 59.

<sup>56</sup> S 6, 10 and 12 of the Insolvency Act.

<sup>57</sup> Sharrock, Smith and Van Der Linde, *Hockly's Insolvency Law* 9<sup>th</sup> edition (2012) Juta & Co 26.

<sup>58</sup> See 2.2.2, above.

<sup>59</sup> Sharrock, *Hockly's* (note 57 above) 26.

<sup>60</sup> See further 5.2.2 below.

of insolvency has been committed, is whether a reasonable person in the position of the receiver of the document, and with the same knowledge of the relevant circumstances, would have interpreted the document in question to mean that the debtor cannot pay his debts.<sup>61</sup>

#### 2.2.4 Friendly sequestration

Creditors frequently rely on the commission by a debtor of an ‘act of insolvency’ in applications for compulsory sequestration commonly referred to as ‘friendly sequestration’, usually motivated by the debtor’s desire to put an end to his financial woes.<sup>62</sup> In *Klemrock (Pty) Ltd v De Klerk and another* (‘*Klemrock*’),<sup>63</sup> Nicholas J referred to the term ‘friendly sequestration’ as meaning that the debtor is anxious to be sequestrated.<sup>64</sup> One of the reasons for the existence of the so-called friendly sequestration is the result of a heavier burden of proof which rests on the applicant in voluntary surrender, to prove advantage to creditors.<sup>65</sup> Frequently, a sympathetic creditor will come to the assistance of a debtor by applying for the compulsory sequestration of the debtor’s estate.<sup>66</sup>

In *Craggs v Dedekind, Baartman v Baartman and another, Van Jaarsveld v Roebuck, Van Aardt v Barrett* (‘*Craggs v Dedekind*’),<sup>67</sup> the court held that friendly sequestrations are viewed with suspicion by courts for various reasons, including the fact that most often than not, the petitioning creditor and the debtors are related and that they are often resorted to in an attempt to abuse the court process.<sup>68</sup> In the result, where the application is brought by a party who does not appear to be acting at arm’s length, but more in a ‘friendly capacity’, with the debtor’s interests, more than those of the creditors, in mind, the court will pay special attention to whether there is reason to believe that sequestration will be to the advantage of creditors in the particular circumstances.<sup>69</sup> If this is not the case, the application for sequestration should be refused.

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<sup>61</sup> See 1995 (3) SA 123 (A).

<sup>62</sup> Mars, *The Law of Insolvency* (note 19) 98.

<sup>63</sup> 1973(3) SA 925(W).

<sup>64</sup> *Klemrock* par 927, See also Evans, ‘The abuse of the process of the court in friendly sequestration proceedings in South Africa’ (note 18 above), the term ‘friendly sequestration’ generally implies that the sequestrating creditor is well acquainted with the debtor, and that the main object of that creditor is to come to the debtor’s assistance.

<sup>65</sup> 2009 (3) SA 376 par 9.

<sup>66</sup> *Ex parte Ford* par 15.

<sup>67</sup> 1996 (1) SA 935 par 935.

<sup>68</sup> *Craggs v Dedekind* par 937.

<sup>69</sup> *Craggs v Dedekind* par 927.

Evans made an important observation in relation to friendly sequestration applications that the element which is mostly not present in these cases is that of ‘advantage to creditors’.<sup>70</sup> Further, Evans expressed concerns about the amendment to the Act did not include provisions to improve on the position regarding friendly sequestration and saw this as a shortcoming on the part of the legislature.<sup>71</sup> He proposed that the amendments to the Act should have contained provisions conferring a judicial discretion to require debtors in friendly sequestration proceedings to comply with the same or similar provisions that are required for the voluntary surrender of the debtor’s estate.<sup>72</sup>

Problematic issues which have arisen, within the context of a conception of sequestration as a debt relief option, in various cases concerning compulsory sequestration, including ‘friendly sequestration’, will be discussed further, below.<sup>73</sup>

## **2.3 Consequences of sequestration**

### **2.3.1 Vesting of assets**

The function of the trustee is to collect the assets in the estate, realise them, and distribute the proceeds amongst creditors in the order of preference laid down by the Insolvency Act.<sup>74</sup> To this end, the Act provides that the effect of a sequestration order, including a provisional order, is to divest the estate of the insolvent and vest it in the Master and thereafter in the trustee upon his appointment.<sup>75</sup> The estate remains vested with the trustee, until the court discharges the sequestration order, or the creditors accept an offer of composition made by the insolvent which provides that the insolvent’s property will be restored to him, or an order for the insolvent’s rehabilitation has been granted in terms of section 124 (3).<sup>76</sup>

### **2.3.2 Rehabilitation and discharge from liability for pre-sequestration debt**

An insolvent debtor whose estate has been sequestrated may apply by *ex parte* application to the high court for rehabilitation.<sup>77</sup> In terms of the Insolvency Act, an insolvent who has not been rehabilitated by the court within ten years from the date of sequestration of his estate, is

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<sup>70</sup> Evans, ‘Unfriendly consequences of a friendly sequestration’ 2003 (15) *SA Merc LJ* 437-447, 444.

<sup>71</sup> Evans, (note 70 above) 444.

<sup>72</sup> Evans (note 70 above) 444.

<sup>73</sup> See 2.4 below.

<sup>74</sup> Sharrock, *Hockly’s* (note 57 above) 48.

<sup>75</sup> Sharrock *Hockly’s* (note 57 above) 48.

<sup>76</sup> Sharrock *Hockly’s* (note 57 above) 48.

<sup>77</sup> Mars, *The Law of Insolvency* (note 19 above) 555.

automatically rehabilitated subject to the proviso, contained in section 127A (1) of the Act, that an interested person may apply to the high court, prior to expiry of the ten-year period, to order otherwise.<sup>78</sup> An insolvent does not have a right to be rehabilitated; it is a matter within the discretion of the court.<sup>79</sup> All the debtor's pre-sequestration debts are discharged upon rehabilitation.

#### **2.4 Shortcomings of sequestration as a debt relief option**

A relatively recent, pertinent, leading case, which illustrates the problems that arise where debtors wish to utilise voluntary surrender as a form of debt relief, is *Ex parte Ford*. In this case, the court dealt with three applications for voluntary surrender of the estates of three debtors.<sup>80</sup> The applicants' liabilities consisted of debts owed to financial institutions or money lenders, either by way of loans on overdraft or otherwise, or as a consequence of the extension of credit through credit-card facilities.<sup>81</sup> Therefore, all the debts of the applicants resulted from 'credit agreements' as defined by the NCA. The applicants argued that: they became insolvent without any fraud or dishonesty on their part; utilising the NCA's debt review and debt re-arrangement mechanisms was not ideal in their circumstances; and, thus, applying for the voluntary surrender of their estate was more appropriate.<sup>82</sup> The Act states that an applicant for voluntary surrender must also satisfy the court that the acceptance of the surrender of the estate in question will be to the advantage of creditors.<sup>83</sup>

Therefore, the court held that it was not disposed to exercise its discretion in favour of granting their applications for voluntary surrender. The court also rejected the applicants' counsel's argument that they were entitled to choose the form of relief that suited their convenience, by virtue of satisfying the relevant statutory requirements under the Insolvency Act. The court held that such approach was misdirected especially where the grant of the selected remedy is discretionary.<sup>84</sup> The court's reasoning in *Ex Parte Ford* is discussed in more detail at 5.2.1.

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<sup>78</sup> Sharrock, *Hockly's* (note 57 above) 147.

<sup>79</sup> Sharrock, *Hockly's* (note 57 above) 147.

<sup>80</sup> *Ex parte Ford* par 2.

<sup>81</sup> *Ex parte Ford* par 2.

<sup>82</sup> *Ex parte Ford* par 2.

<sup>83</sup> S 6 of the Insolvency Act.

<sup>84</sup> *FirstRand Bank Ltd v Evans* 2011 (4) SA 597 par 19.

Another recent case, which highlights problems associated with debtors resorting to voluntary surrender as means of seeking debt relief, is *Ex parte Cloete*<sup>85</sup> The applicant debtor owed a bank an amount of R170 560.55 arising from four separate debts, three being in respect of loans of money and a fourth based on vehicle finance provided to purchase a vehicle, valued at R130 000, which was the only asset of the debtor.<sup>86</sup> The applicant was an engine driver and had lost his job in 2009 and was unemployed for a certain period of time, thereafter obtained employment but at a much lower salary.<sup>87</sup> The applicant sold all his assets except his motor vehicle. He further applied for debt review but could no longer afford to make the agreed monthly payments.<sup>88</sup>

The court reiterated that the substantive requirements were that the applicant must be insolvent; the applicant must own realizable property of a sufficient value to defray all costs of sequestration; and that the sequestration will be to the advantage of the applicant's creditors.<sup>89</sup> The court pointed out that the test to establish that it is to the advantage of creditors for the estate to be sequestrated is more stringent in cases of voluntary surrender than in compulsory sequestration applications.<sup>90</sup> The court also observed a recent trend to launch applications for acceptance of the surrender of debtors' estates, as is the case with so called 'friendly sequestrations',<sup>91</sup> the main purpose being the advantage of debtors, but which unfortunately brought with it disadvantages for creditors. The court stated that this could not be what the legislature had in mind.<sup>92</sup> The court also cautioned that various courts in South Africa have warned over the years against abuse of process pertaining to friendly sequestrations as well as application for voluntary surrender. The court was of the view that it must also add its voice and try to prevent debtors from abusing the system to the detriment of creditors.<sup>93</sup> The court found support for its approach in a quotation from the judgment of Holmes J, in *Ex parte Pillay; Mayet v Pillay* ('*Pillay*'),<sup>94</sup> that 'the machinery of voluntary

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<sup>85</sup>(1097/2013) 2013 ZAFSHC 45 (5 April 2013).

<sup>86</sup> *Ex parte Cloete* par 3. Presumably, the vehicle was still owned by the credit provider, according to standard practice adopted in respect of financial loans.

<sup>87</sup> *Ex parte Cloete* par 3.

<sup>88</sup> *Ex parte Cloete* par 3.

<sup>89</sup> *Ex parte Cloete* par 7.

<sup>90</sup> *Ex parte Cloete* par 8.

<sup>91</sup> For discussion of friendly sequestration, see 2.2.4 above.

<sup>92</sup> *Ex parte Cloete* par 10.

<sup>93</sup> *Ex parte Cloete* par 13.

<sup>94</sup> 1955 (2) SA 309 (N).

surrender was primarily designed for the benefit of creditors, and not for the relief of harassed debtors.<sup>95</sup>

The court also noted that most friendly sequestration applications often raised doubts as to the relationship between the attorney, valuator or between the debtor and valuator. In the present case, the court was concerned that the relationship between the valuator, attorney and applicant ‘raised eyebrows’.<sup>96</sup> Therefore the court agreed with the decision in *Ex Parte Arntzen*<sup>97</sup> that voluntary surrender required an even higher level of disclosure than friendly sequestration and it was appropriate to require compliance with the guidelines set out in *Mthimkhulu v Rampersad* (‘*Mthimkhulu*’).<sup>98</sup>

In respect of the issue of advantage to creditors, the court stated that previously, in voluntary surrender and friendly sequestration, once it was established that a dividend of 10c in the rand would be payable to concurrent creditors, an advantage to creditors would have been proved. However, the court was of the view that an advantage to creditors required a dividend of 20c in the rand. In *Ex parte Ogunlaja and others*<sup>99</sup> the court also took the view that 10c in the rand was insufficient and a dividend of 20c in the rand is regarded as the minimum benefit that would have to be established before a voluntary surrender or compulsory sequestration application is granted.<sup>100</sup> The court held that the applicant’s failure to disclose his income and expenditure was highly relevant insofar as the total of the concurrent claims was relatively small. If the income expenditure was fully disclosed, it might have had an effect on considerations pertaining to the advantage to creditors.<sup>101</sup>

The court concluded that the application should be dismissed for not fulfilling the requirements of section 6 of the Insolvency Act, further the court stated that it will not consider whether the non-compliance would have been condoned in a suitable case. The court dismissed the application on the basis that it was not satisfied that the advantage to creditors had been shown to exist.<sup>102</sup> The court held that the case was a typical situation where the applicant should have utilised that provisions of the NCA in order to deal with his financial

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<sup>95</sup> *Ex parte Pillay* par 311.

<sup>96</sup> *Ex parte Cloete* par 15.

<sup>97</sup> 2013 (1) SA 49 (KZP).

<sup>98</sup> 2002 (3) SA 512 (N).

<sup>99</sup> 2011 JOL 27029.

<sup>100</sup> *Ex parte Cloete* par 23.

<sup>101</sup> *Ex parte Cloete* par 25.

<sup>102</sup> *Ex parte Cloete* par 30.

problems. In this way he would have been protected against harassment from creditors who on the other hand, would have eventually received full payment of their claims.<sup>103</sup> The court advised that all debtors, especially those with small and medium sized estates, should as a starting point embrace the protection of the NCA if the claim fell within the scope of the Act.<sup>104</sup> The court held that insolvency must always be the last resort and as a general rule it was not acceptable that debtors used the machinery of the Insolvency Act to get rid of the creditors.<sup>105</sup>

As far as concerns compulsory sequestration, especially in friendly sequestration applications, in which, essentially, the parties seek debt relief for the debtor, as opposed to securing financial advantage for the creditors, a number of reported judgments expose the limitations, in this regard, inherent in the South African insolvency law mechanisms. In *Epstein v Epstein* ('*Epstein*')<sup>106</sup> the debtor's mother applied for the sequestration of her son's estate on the basis of a letter which he had written informing her that he could not repay to her a loan which she had extended to him. In the circumstances, the court found that sequestration held no advantage for creditors and that the application had been brought primarily to avoid civil imprisonment for unpaid debts.<sup>107</sup> Seligson AJ stated that 'the Court should not readily encourage the avoidance of the statutory safeguards for creditors by sanctioning recourse to a friendly sequestration via the easy route of s[ection] 8 (g) of the Act, unless it is clear that the general body of creditors will benefit.'<sup>108</sup>

In *Craggs v Dedekind* the court also dealt with four different friendly sequestration applications. In one application the petitioner had lent the first respondent R1000 in January 1995 to pay some of his debts.<sup>109</sup> The loan repayment was said to have been outstanding since March 2005. The court noted that the fact that this was a friendly sequestration was evidenced by the small amount that was claimed and the fact that he chose sequestration where he could have sued his debtor in a small claims court.<sup>110</sup> In another application the petitioner had lent the respondent R20 000 since his business was doing badly and in need of working capital.<sup>111</sup>

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<sup>103</sup> *Ex parte Cloete* par 27.

<sup>104</sup> *Ex parte Cloete* par 24.

<sup>105</sup> *Ex parte Cloete* par 24.

<sup>106</sup> 1987 (4) SA 206 (C).

<sup>107</sup> Sharrock, *Hockly's* (note 57 above) 33.

<sup>108</sup> Sharrock, *Hockly's* (note 57 above) 33.

<sup>109</sup> *Craggs v Dedekind* par 938.

<sup>110</sup> *Craggs v Dedekind* par 938.

<sup>111</sup> *Craggs v Dedekind* par 938

At the outset the court stated that friendly sequestrations shared certain characteristics. The debt which the sequestrating creditor relies upon is almost always a loan, usually a small loan without security of any sort.<sup>112</sup> Further the agreement is usually not reduced to writing and the only writing that is produced to the court is the letter stating that the debt cannot be paid.<sup>113</sup> Sometimes the details of the respondent's assets and liabilities will be set out.<sup>114</sup> The court also noted that in friendly sequestrations the debtor and the creditor are often related in that fathers sequester sons, wives sequester husbands and sweethearts sequester each other with no potential damage on their relationship.<sup>115</sup>

In light of these factors the court cautioned that a court should be on its guard when the signs are there. Further the court held that courts should be forgiven for requiring rather more from a friendly petitioner than it might otherwise do and that, consequently a friendly petitioner must present sufficiently detailed evidence to satisfy a sceptical court that he indeed has a claim against the respondent.<sup>116</sup>

In *Mthimkhulu*, the court observed that the facts of the case illustrated the manner in which the process of friendly sequestration had been abused and continues to be abused.<sup>117</sup> The court then set out the minimum requirements for an application for the sequestration of a debtor's estate by a friendly creditor. The requirements read as follows:

- (i) sufficient proof of the applicant's locus standi;
- (ii) sufficient documentary proof of the debt;
- (iii) reasons should be given for the fact that the applicant had no security for the debt;
- (iv) a full and complete list of the respondent's assets and acceptable evidence upon which the court could determine their true market value;
- (v) in case of immovable property, the valuer should prove his or her qualifications to make the valuation and give details of his or her experience;
- (vi) notice of the application should be given to the bondholder; and

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<sup>112</sup> *Craggs v Dedekind* par 937.

<sup>113</sup> *Craggs v Dedekind* par 937.

<sup>114</sup> *Craggs v Dedekind* par 937.

<sup>115</sup> *Craggs v Dedekind* par 937.

<sup>116</sup> *Craggs v Dedekind* par 937.

<sup>117</sup> *Mthimkhulu* par 515.

- (vii) full and acceptable reasons on affidavits should be given for an application for the execution of a provisional order.<sup>118</sup>

More recently, in *Plumb on Plumbers v Lauderdale and another* ('*Plumb on Plumbers*'),<sup>119</sup> the court referred to *Mthimkhulu*. In this case the court noted that, in the application papers, that some of the allegations of fact in the founding affidavit matched with those of a previous application that had come before the court.<sup>120</sup> Further, it appeared to the court that the sequestration applications were coming from the same office of attorneys. The suspicion was highlighted by the fact that, in many of the applications, proof of service of the provisional order was by way of an affidavit from the debtor who had been provisionally sequestered. After carefully considering these facts and noting the similarities in this case with previous applications that came before it, it held that, as stated in *Mthimkhulu*, the facts of the case illustrated a manner in which the process of the friendly sequestration has been abused and continued to be abused.<sup>121</sup>

Another serious shortcoming of the insolvency system in South Africa is the 'advantage to creditors' requirement which has been subjected to a great deal of criticism. A debtor who cannot prove this requirement is left without a formal remedy providing debt relief as well as discharge from liability.<sup>122</sup> Meskin submitted that, in the circumstances where a debtor is unable to pay his debts, wholly or in part, and he seeks to escape commercial harassment, it really should be irrelevant whether he has property and, if he has such, what it will contribute towards the meeting of costs and claims of creditors.<sup>123</sup> Meskin suggested that '[t]he justification for sequestration should be seen in the very fact that its institution will enable the process of administration in insolvency to ensue, which will determine whether property exists or can be recovered, from which costs of claims can be met.'<sup>124</sup>

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<sup>118</sup> *Mthimkhulu* par 515.

<sup>119</sup> 2013 (1) SA 60 (KZD).

<sup>120</sup> *Plumb on Plumbers* par 2.

<sup>121</sup> *Plumb on Plumbers* par 8. See also Mabe and Evans, 'Abuse of sequestration proceedings in South Africa revisited' (2014) 26 SA *Merc LJ* 652, where it was noted that it has been pointed out that dishonesty in insolvency proceedings places a burden on creditors and the economy in general.

<sup>122</sup> *Ex parte Ford* par 23.

<sup>123</sup> Meskin, "'Advantage to creditors': a misconceived requirement' Paper presented at the Annual Banking Law Update, held at Rand Afrikaans University (now the University of Johannesburg), Johannesburg, August 1995 3 (copy on file with author).

<sup>124</sup> Meskin (note 123 above) 3.

Meskin further submitted that, in most cases, it is mere speculation as to whether or not there is reason to believe that sequestration will be to the advantage of creditors.<sup>125</sup> He proposed that, ‘the process of administration of the sequestrated estate should be allowed to function precisely for the very purpose of determining whether it will yield any advantage to creditors.’<sup>126</sup> He further submitted that:<sup>127</sup>

‘where a creditor can prove that his debtor has committed an act of insolvency, or is in fact insolvent and the creditor is willing to pay for the costs of the sequestration, which will not be payable out of the property of the estate, such creditor ought not to be denied sequestration because he lacks evidence to show the existence of reason to believe that sequestration would be advantageous to creditors’.

More recently, a number of academic commentators have highlighted the challenges faced by consumer debtors, seeking to rely on voluntary surrender, who do not have sufficient assets to satisfy the advantage to creditors’ requirement.<sup>128</sup> Roestoff and Coetzee submitted that the sequestration applications are already expensive because they are high court applications and therefore the stringent requirement of ‘advantage to creditors’ imposed by the Insolvency Act places a further stumbling block for debtors wishing to use its machinery.<sup>129</sup> Further, Evans made an important observation that although the Insolvency Act does not differentiate between the classes of debtors in accordance with their differing or changing circumstances, the Act does in fact differentiate between those ‘rich debtors’ who are able show that the sequestration of their estate will benefit their creditors and the ‘poor debtors’ who cannot prove this.<sup>130</sup> A consequence is that poor debtors are left to the mercy of their creditors while those debtors who are able to prove the advantage to creditors have a prospect of rehabilitation and a discharge from liability for pre-sequestration debts.<sup>131</sup>

The Commission has recommended that the advantage to creditors requirement be retained. This will in effect results in debtors with few or no assets being excluded from enjoying a debt relief mechanism which provides discharge or what is termed a ‘fresh start’ in some foreign jurisdictions, as part of its dispensation. Commentators have called for South African

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<sup>125</sup> Meskin (note 123 above) 6.

<sup>126</sup> Meskin (note 123 above) 6.

<sup>127</sup> Meskin (note 123 above) 6.

<sup>128</sup> Steyn (note 5 above) 339.

<sup>129</sup> Roestoff and Coetzee (note 26 above) 55.

<sup>130</sup> Evans (note 64 above) 508.

<sup>131</sup> *Ex Parte Ford* par 29.

insolvency law to be amended to cater for the poorest debtors and alleviate their difficulties.<sup>132</sup>

## 2.5 Conclusion

The machinery of the Insolvency Act provides for sequestration of a debtor's estate, either by voluntary surrender, at the instance of the debtor himself, or by compulsory sequestration of the debtor by a creditor, or creditors.<sup>133</sup> A high court order for the sequestration of a debtor's estate suspends or prevents the institution of, as the case may be, legal action by creditors against the debtor. Thereafter, creditors must lodge claims against the insolvent estate, which is administered by a trustee in whom all of the non-exempt assets of the estate vest and who is under a duty to liquidate them and to distribute the proceeds to creditors in accordance with the Insolvency Act's provisions. An insolvent debtor may be rehabilitated, a consequence of which is that he will be discharged from liability for pre-sequestration debt. In these respects, sequestration may be regarded as a debt relief mechanism for an insolvent debtor.<sup>134</sup>

However, that sequestration will be to the advantage of creditors must be proved before the court may grant a sequestration order and, even where this has occurred, and all of the other requirements have been met, the court nevertheless has the discretion whether to grant or refuse an order of sequestration.<sup>135</sup>

Given the more stringent requirements for voluntary surrender, it may be understood why debtors and sympathetic creditors resort to friendly sequestration as a means to obtain debt relief for overburdened debtors. However, the scepticism and the cautious approach of courts towards friendly sequestration, and their insistence on clear proof of advantage to creditors, tend to frustrate their efforts in this regard.<sup>136</sup>

Thus the Insolvency Act's requirement of advantage to creditors, for a sequestration order to be granted, results in this procedure providing inadequate debt relief for debtors. The effectiveness of the debt relief option provided by the Insolvency Act can be questioned for differentiating between debtors with assets and those without. It is submitted that our law

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<sup>132</sup> Steyn (note 5 above) 219-220.

<sup>133</sup> Mars, *The Law of Insolvency* (note 19 above) 1.

<sup>134</sup> See 2.3.2.

<sup>135</sup> See 2.1.

<sup>136</sup> See *Craggs v Dedekind*.

requires reform to address this issue and to ensure that debtors with no income and no assets are also accommodated.<sup>137</sup>

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<sup>137</sup> See 2.4.

## CHAPTER THREE

### ADMINISTRATION ORDERS IN TERMS OF THE MAGISTRATES' COURTS ACT 32 OF 1944

#### 3.1 Introduction

An administration order is a debt relief option which assists a debtor who is in financial distress. In terms of section 65I of the Magistrates' Courts Act ('MCA')<sup>138</sup> an administration order may also be granted in favour of a judgment debtor during a section 65 enquiry into the debtor's financial position.<sup>139</sup> In an administration order, a debtor makes payments in instalments which are distributed to his creditors.<sup>140</sup> Administration orders are available only to debtors whose total debts does not exceed R50 000. The process is initiated by means of an application by an individual debtor, made to a magistrate's court, in terms of sections 74 and 65I of the MCA.<sup>141</sup>

It should be noted that this form of debt relief has been subject to abuse and equally has been criticised for not providing adequate debt relief for debtors. The inadequacy of administration orders is related *inter alia* to the monetary cap of R50 000 which excludes debtors with debts exceeding this amount. Further, administration orders lack provisions for debt discharge after a certain period. This chapter will look at the provisions of section 74 of the MCA and set out the procedure and requirements for administration orders as a form of a debt relief option and will identify some of the problems which are associated with this debt relief system

#### 3.2 Administration: procedure, requirements and related issues

A debtor who is unable to pay an amount of any judgment against him or unable to meet his financial obligations may apply to have his estate placed under administration.<sup>142</sup> Further, for a debtor to use section 74 he must have debts not exceeding R50 000. The procedure is initiated by a debtor by applying to court together with a statement of affairs in which the debtor affirms on oath that the names of the creditors and all other declarations made are true.<sup>143</sup> The administration order must be in prescribed form and must set out that the debtor's estate has been placed under administration, an administrator has been appointed and the

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<sup>138</sup> Magistrates' Courts Act 32 of 1944.

<sup>139</sup> S 74(1) of the MCA.

<sup>140</sup> Boraine, 'Some thoughts on the reform of administration orders and related issues' (2003) 36 *De Jure* 217-251, 230.

<sup>141</sup> Boraine (note 140 above) 256.

<sup>142</sup> S 74(1) of the MCA.

<sup>143</sup> S 74A (3) of the MCA.

amount that the debtor is obliged to pay. The application is lodged with the clerk of the magistrate court where the debtor resides or carries on business or is employed.<sup>144</sup> The application is further delivered either personally or by registered post to the debtor's creditors at least three days before the hearing.<sup>145</sup> An administration order provides for the appointment of an administrator and for the payment of the debtor's debt in instalment.<sup>146</sup> As part of the administrator's duties he must pay the cost of the application for the administration order as a first claim against the moneys received by him, unless the court orders otherwise.<sup>147</sup> If the application is successful it compels creditors to accept re-arrangement of the due and payable debt. It should be noted that *in futuro* debts are excluded from the administration order.<sup>148</sup>

In terms of an administration order the debtor is obliged to make either monthly or weekly payment to the administrator. The task of the administrator is to deduct necessary expenses for the debtor and his own remuneration, which is determined by a prescribed tariff, and thereafter make regular distributions out of the payment to all proven creditors.<sup>149</sup> The MCA provides for a hearing of an application for an administration order and any creditor may attend it and furnish proof of his debt and object to any debt listed by the debtor in the statement of affairs.<sup>150</sup> The MCA also provides that the debtor may be interrogated by the court and any creditor or legal representative for such creditor with regard to the debtor's assets and liabilities, his present and future expenses and all of his dependents living with him, his standard of living and the possibility of economising and any other facts that the court may deem relevant. This enquiry into the debtor's affairs assists the court to establish how much a debtor can afford weekly or monthly.<sup>151</sup>

An administration order only lapses when the debtor has paid all listed creditors in full.<sup>152</sup> Therefore, similar to the debt review of the NCA, it does not provide for discharge because

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<sup>144</sup> S 74A (5) of the MCA.

<sup>145</sup> S 74A (5) of the MCA.

<sup>146</sup> S 74E of the MCA.

<sup>147</sup> S 74L (1) (a) of the MCA.

<sup>148</sup> Boraine, Van Heerden & Roestoff, 'A comparison between formal debt administration and debt review – the pros and cons of these measures and suggestions for law reform' (2012) 1 *De Jure* (Part 1) 62-80, 86.

<sup>149</sup> S 74 (c) of the MCA.

<sup>150</sup> S 74B (a) of the MCA.

<sup>151</sup> S 74B (e) of the MCA.

<sup>152</sup> S 74 MCA.

there is no fixed time within which debts must be paid; therefore, many debtors fall into a debt-trap.<sup>153</sup>

### **3.3 Shortcomings of administration as a debt relief option**

Administration orders have been severely criticised for inherent shortcomings as a debt relief option. This paper will not discuss all of the shortcomings but will place emphasis on the monetary cap of R50 000; the lack of provision for a discharge; the application of administration orders being an act of insolvency; and the abuse of the administration process

#### **3.3.1 R50 000 monetary cap**

Although administration orders do provide debt relief for over-indebted debtors, it has been submitted that their application is limited in that they are only available to debtors with debts not exceeding R50 000.<sup>154</sup> The effect of this limitation is that debtors with debts exceeding the stipulated monetary cap are excluded from seeking debt relief under this remedy.<sup>155</sup> It has been submitted that, if the monetary cap was increased, it would provide a wider ambit for debtors to use this option, especially those debtors who are currently excluded from the relief offered in the Insolvency Act since they cannot prove advantage to creditors as required by the Insolvency Act.<sup>156</sup>

#### **3.3.2 Lack of provision for discharge**

It has already been established that, except for sequestration, none of the debt relief options provide for a discharge. Section 74 does not provide for discharge to a debtor whose estate is under administration. It is evident that alternatives to sequestration in the South African's insolvency law regime do not offer a consumer what is termed, in the United State of America, as a 'fresh start'. Although in *African Bank Ltd v Weiner and other*,<sup>157</sup> the court held that it was never the intention of the legislature to have a debtor bound indefinitely in an

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<sup>153</sup> Roestoff *et al*, 'The debt counselling process – Closing the loopholes in the National Credit Act 34 of 2005' (2009) 12 *PELJ* 247-360, 260.

<sup>154</sup> Boraine, Roestoff & Coetzee, 'Background to certain aspects relating to consumer insolvency in South Africa Center of advanced corporate and insolvency law', University of Pretoria 5.

<sup>155</sup> Boraine, Van Heerden & Roestoff, 'A comparison between formal debt administration and debt review – the pros and cons of these measures and suggestions for law reform' (2012) 2 *De Jure* (Part 2) 254 -271, 255.

<sup>156</sup> Boraine, Van Heerden and Roestoff (note 155 above) 231.

<sup>157</sup> 2005 (4) SA 363 (SCA).

administration order, the lack of such provision may result in a debtor being subject to the administration order for the rest of his life.<sup>158</sup>

### 3.3.3 Application for administration as an act of insolvency

Section 8 of the Insolvency Act designates certain acts or omissions as acts of insolvency.<sup>159</sup> Section 8(g) of the Act provides that a debtor has committed an act of insolvency if he gives written notice of inability to pay any of his debts. Courts have held that this act of insolvency is committed when a debtor makes an application for an administration order under section 74 of the MCA unless the statement of assets and liabilities shows that the debtor is not insolvent and could be compelled to pay his debts in full.<sup>160</sup> For example, in *Madari v Cassim*<sup>161</sup> the respondent, who was in the business of selling fruits and vegetables and had three stalls at the market, filed for an application for administration order under section 74 of the MCA. He made £60 per month and, his business having fallen into financial difficulties, he had offered to pay his creditors £10 per month for distribution under the administration order.<sup>162</sup>

In an application for the sequestration of his estate the court stated that the act of insolvency committed by the respondent was the very fact of making an application for an administration. The court further stated that the respondent had resorted to this remedy as he was unable to discharge his liabilities and had insufficient assets capable of attachment to satisfy such liabilities. In the course of applying for administration gave notice in writing to all his creditors that he was unable to pay any of his debts and such an act, the court held, constituted an act of insolvency as contemplated in section 8(g) of the Insolvency Act. Thus, when a debtor, who wishes to retain his assets, applies for an administration order, it creates the opportunity for his creditors to apply for the sequestration of his estate. This position is undesirable.

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<sup>158</sup> Boraine, Van Heerden and Roestoff (note 155 above) 256. See also Boraine and Roestoff 2014 *THRHR* (note 3 above) 354, where the authors stated that without some provisions for discharge in a debt relief procedure, many debtors will remain debt trap.

<sup>159</sup> See 2.2.3.

<sup>160</sup> Mars, *The Law of Insolvency* (note 19 above) 98.

<sup>161</sup> 1953 (2) SA 35 (D).

<sup>162</sup> *Madari v Cassim* par 156.

### 3.3.4 Administration orders an abuse of process

A large scale of abuse of process has been identified in the manner in which administration orders are administered. In the first instance administrators, unlike debt counsellors are not govern by any regulatory body as a result anyone can become an administrator as there are no prescribed requirements or qualifications to become one. The absence of a regulatory body for administrators has resulted in the courts appointing persons without appropriate qualifications as administrators e.g. people with unsettled debts themselves and people who have been struck of the roll as attorneys.<sup>163</sup> These administrators encourage debtors who with have otherwise benefitted from another resolution to go under administration and this increases the debtor's debt and benefit only the administrator.<sup>164</sup> Another abuse is that of administrators overcharging for remuneration and expenses and thus adding to the debtor's burden.<sup>165</sup>

Boraine notes that, the increase in number of consumers being able to access credit has not only lead to more debtors finding themselves in a debt trap, but has also led to a growing number of entities offering the services of assisting over-indebted consumers by placing them under administration.<sup>166</sup> A large number of debtors are being misled into the process as a result of being advised with inaccurate information by administrators- the debtors are seldom advised about the costs of the application for administration orders or what the administrator's fees will be.<sup>167</sup> In essence this means that a debtor is not properly informed on how the process of administration works, except by being told that his debts will be re-arranged and they must make a certain amount of payment every month. The shortcomings set out above are one of the many reasons why this debt relief option does not provide adequate debt relief to debtors.

### 3.4 Conclusion

Administration orders were designed to come to the rescue of debtors who found themselves in financial crisis, and who could not use the provisions of the Insolvency Act – as explained earlier, administration is an easy and less expensive procedure than, although akin to sequestration. The administration procedure may only be initiated by a debtor who has a

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<sup>163</sup> Boraine, Van Heerden and Roestoff (Part 2) (note 155 above) 230.

<sup>164</sup> Boraine, Van Heerden and Roestoff (Part 2) (note 155 above) 230.

<sup>165</sup> Boraine, Van Heerden and Roestoff (Part 2) (note 155 above) 230.

<sup>166</sup> Boraine, Van Heerden and Roestoff (Part 2) (note 155 above) 230.

<sup>167</sup> Boraine, Van Heerden and Roestoff (Part 2) (note 155 above) 231.

judgment debt against him or who is going through financial difficulties.<sup>168</sup> However, various shortcomings have been identified in relation to this debt relief option. These include the monetary limitation of R50 000, the lack of provision for discharge to debtor, the fact that application for an administration order is categorised as an act of insolvency as well as the large scale of abuse regarding administration orders.<sup>169</sup> In light of the problems associated with administration orders, it remains doubtful whether this debt relief option does in fact provide adequate debt relief for over-indebted debtors.

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<sup>168</sup> See 3.1.

<sup>169</sup> See 3.3.

## CHAPTER FOUR

### DEBT REVIEW AND DEBT RE-ARRANGEMENT IN TERMS OF THE NATIONAL CREDIT ACT 34 OF 2005

#### 4.1 Introduction

One of the main objectives of the NCA, which came into full operation on 1 June 2007, is to afford debt relief to over-burdened consumers.<sup>170</sup> The NCA seeks to achieve this objective through the provisions creating and regulating the mechanism of debt review.<sup>171</sup> The NCA promotes the notion of debtors fulfilling their debts in full. The form of debt relief envisaged, therefore, is that a consumer debtor may, by way of debt review eventually obtain a rescheduling of his credit agreement debt, either by means of a voluntary re-arrangement plan with all of his credit providers or as ordered by a court.<sup>172</sup>

This chapter discusses the NCA's debt review provisions and identifies some shortcomings of the debt review system. Pertinent provisions of the NCA will also be discussed below, in Chapter 5.

#### 4.2 Objectives of the NCA

The objectives of the NCA are expressed in its section 3 and include, *inter alia*, to:

- (i) promote responsibility in the credit market, by encouraging consumers to borrow responsibly;
- (ii) avoid over-indebtedness;
- (iii) fulfil their financial obligations; and
- (iv) discourage reckless credit granting by credit providers and contractual default by consumers.<sup>173</sup>

The NCA does not only aim to assist consumers who are over-indebted, but it also to a large extent aims to prevent over-indebtedness by incorporating provisions geared towards consumer education.<sup>174</sup>

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<sup>170</sup> S 3 of the NCA.

<sup>171</sup> Van Heerden and Boraine, 'The interaction between debt relief measures in the National Credit Act 34 of 2005 and Aspects of Insolvency law' (2009) 12 (3) *PELJ* 22-161, 22.

<sup>172</sup> Van Heerden and Boraine (note 171 above) 22.

<sup>173</sup> Van Heerden and Boraine (note 171 above) 22.

<sup>174</sup> S 3 of the NCA.

### 4.3 Definition of over-indebtedness

Van Heerden and Boraine submitted that over-indebtedness has a very specific meaning within the NCA, as it only applies to debts that arise out of credit agreements and that fall within the scope of the NCA.<sup>175</sup> Section 79 of the NCA provides the definition for over-indebtedness. According to section 79 (1) (a) -

a consumer is over-indebted if the preponderance of available information at the time a determination is made, indicates that the particular consumer is or will be unable to satisfy in a timely manner all the obligations under all the credit agreements to which the consumer is a party, having regard to that consumer's-

- (a) financial means, prospects and obligations; and
- (b) probable propensity to satisfy in a timely manner all the obligations under all the credit agreements to which the consumer is a party, as indicated by the consumer's history of debt repayment.<sup>176</sup>

Section 79 (2) goes on to say that, when a determination is to be made whether a consumer is over-indebted or not, the person making that determination must apply the criteria set out in subsection (1) as they exist at the time the determination is being made.<sup>177</sup>

A mere allegation of over-indebtedness is insufficient. The over-indebtedness should be established on a balance of probabilities as envisaged by section 79 (1), which refers to the preponderance of available information at the time a determination is made.<sup>178</sup> The way in which over-indebtedness is addressed is by making provision for debt review and debt restructuring.<sup>179</sup> A consumer debtor is required to make an application to be declared over-indebted.<sup>180</sup> If it is alleged that the consumer under a credit agreement is over-indebted, despite anything to the contrary the court has the power to refer the matter directly to a debt counsellor requesting the debt counsellor to evaluate the consumer's circumstances and make a recommendation to the court in terms of section 86 or declare the debtor over-indebted and make an order, as set out in section 87, to address the debtor's over-indebtedness.

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<sup>175</sup> Van Heerden and Boraine (note 171 above) 31.

<sup>176</sup> S 79 of the NCA.

<sup>177</sup> S 79 (2) of the NCA.

<sup>178</sup> Boraine, 'The Reform of Administration Orders Within a New Consumer Credit Framework' in Kelly-Louw M *et al* (eds) *The Future of Consumer Credit Regulation Creative Approaches to Emerging Problems* (Ashgate Publishers 2008) 187-216.

<sup>179</sup> Boraine (note 178 above) 6.

<sup>180</sup> Boraine (note 178 above) 6.

#### 4.4 Debt review in terms of the NCA

The NCA introduced the debt review process for debt arising out of credit agreements whereby a consumer is either referred to the debt counsellor or he seeks the services of the debt counsellor on his own initiative before debt enforcement procedures are commenced against him.<sup>181</sup> In certain circumstances the consumer may approach the court for debt review.<sup>182</sup> However, it must be noted that the NCA only applies to debts as defined in the Act itself and not all debts are covered by it. Consumer debtors, who are under the debt review process, may utilise other debt relief measures, such as voluntary surrender or administration orders.<sup>183</sup> The court also has discretion to refer the matter for debt review during any pending procedure in a court that is concerned with a credit agreement. However, debt review will cover only those agreements entered into before the institution of legal action.<sup>184</sup> In light of the enactment of the new section 8A of the Insolvency Act, a debtor who applies for debt review is not deemed to have committed an act of insolvency in terms of the Insolvency Act.

The process of debt review commences when a consumer applies to the debt counsellor to be declared over-indebted and to be placed under debt review. At the initial stages of the debt review process, the debt counsellor must review the debtor's credit agreements to establish whether he is in fact over-indebted and whether reckless credit was granted.<sup>185</sup> Notwithstanding any provisions of law or agreement to the contrary, if it appears in any court proceedings in which a credit agreement is considered that the consumer is over-indebted, the court is given a discretion in terms of section 85 of the Act to either refer the matter to the debt counsellor and request the debt counsellor to evaluate the consumer's circumstances and make a recommendation to the court in terms of section 86 (7) or to declare and relieve the over-indebtedness and make an order in terms of section 87.<sup>186</sup> Consumers who are over-indebted may therefore apply for debt review or alternatively wait for a creditor to enforce a credit agreement in respect which the consumer is in default and then raise the issue of over-indebtedness in court.

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<sup>181</sup> Boraine (note 178 above) 6.

<sup>182</sup> Boraine (note 178 above) 5.

<sup>183</sup> Boraine (note 178 above) 5.

<sup>184</sup> Boraine (note 178 above) 7.

<sup>185</sup> S 86 (6) (7) of the NCA.

<sup>186</sup> S 85 (a) (b) of the NCA.

If a debt counsellor makes a recommendation in terms of section 86 (7) (b) of the NCA<sup>187</sup> between the consumer debtor and the credit provider and the debtor and his service provider accept the proposal, the debt counsellor is required to record the proposal and if the consumer debtor and each credit provider consent, file the proposal as a consent order.<sup>188</sup> However, if the proposal is not accepted the debt counsellor must refer the matter to the magistrate court with the recommendations.

In terms of section 86 (7) (c) of the NCA, the debt counsellor may issue a proposal, recommending that the magistrate's court make either or both of the following orders: that -

- (i) one or more of the consumer's credit agreements be declared reckless credit, if the debt counsellor has concluded that those agreements appear to be reckless; or
- (ii) one or more of the consumer's obligations be re-arranged by:
  - extending the period of the agreement and reducing the amount of each payment due accordingly;
  - postponing during a specified period the dates on which payments are due under the agreement;
  - extending the period of the agreement and postponing during a specified period the dates on which payments are due under the agreement; or
  - recalculating the consumer's obligations because of contraventions of Part A or B of Chapter 5, or Part A of Chapter 6.<sup>189</sup>

If a debt counsellor rejects the debtor's application, the consumer, with leave of the magistrate's court, may apply directly to the magistrate's court to have his debt re-arranged as contemplated by section 86 (7) (c). If a consumer is in default under a credit agreement that is under review, the credit provider in respect of that credit agreement may give notice to the debtor, debt counsellor and the National Credit Regulator that he is terminating the

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<sup>187</sup> S 86 (7) (b) of the NCA provides that if a debt counsellor makes a proposal to the magistrate's court in terms of section 86 (8) (b), or a consumer applies to the magistrate's court in terms of section 86 (9), the magistrate's court must conduct a hearing and, having regard to the proposal and information before it and the consumer's financial means, prospects and obligations, may make - (i) an order declaring any credit agreement to be reckless, and an order contemplated in section 83 (2) or (3), if the Magistrate's Court concludes that the agreement is reckless; (ii) an order re-arranging the consumer's obligations in any manner contemplated in section 86 (7) (c) (ii); or (iii) both orders contemplated in subparagraph (i) and (ii).

<sup>188</sup> S 86A (8) of the NCA.

<sup>189</sup> S 86 (7) of the NCA.

review. However, the magistrate's court still has the power to order that debt review be resumed on any conditions the court considers to be just in the circumstances.

#### **4.5 Shortcomings of debt review as a debt relief option**

A number of problems with the NCA have been identified in the media and by academics since its enactment and implementation.<sup>190</sup> In this dissertation two of these issues will be identified and discussed. These issues are: first, the fact that the NCA makes no provision for any form of discharge from indebtedness for the consumer; and secondly, debt review does not constitute a bar to the sequestration of the debtor's estate.

As mentioned in above, it is clear from the expressly stated objectives of the NCA that debt review is not aimed at offering debtors a formal discharge from liability for their debts. Although one of the objectives of the NCA is to provide debt relief through re-arrangement of debts where a debtor is over-indebted, this debt relief option is still premised on the principle of full satisfaction.<sup>191</sup> Johnson and Meyerman submit that the NCA, despite its aims to assist over-indebted consumers, only perpetuates the over-indebtedness by lacking provision for a discharge mechanism.<sup>192</sup> Thus the effect is that debt review will never afford an opportunity to a consumer debtor to obtain a discharge from his pre-existing indebtedness.<sup>193</sup> The lack of discharge provisions in the NCA may also result in debtors remaining in debt almost indefinitely and cause an escalation in the amount of the debt, due to the cost and interest factor.<sup>194</sup>

The fact that a debtor who has applied for, or is subject to, debt review is not precluded from having his estate sequestrated is another serious shortcoming of the process. This issue will be discussed in chapter 5 which deals with the interface between the Insolvency Act and the NCA.<sup>195</sup>

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<sup>190</sup> Steyn (note 3 above) 395. See also Otto & Otto, *National Credit Act explained* 2<sup>nd</sup> edition (2010) LexisNexis 134.

<sup>191</sup> See s 3 of the NCA.

<sup>192</sup> Roestoff and Coetzee, 'Consumer Debt Relief in South Africa - Should the Insolvency System Provide for NINA Debtors? Lessons from New Zealand' (note 1 above) 18, footnote 91 of the article.

<sup>193</sup> Boraine Van Heerden and Roestoff Part 1 (note 148) 102.

<sup>194</sup> Boarine, Roestoff and Coetzee (note 154) 10. See also Boraine and Roestoff, 'Revisiting the state of consumer insolvency in South Africa after 20 years: The court's approach, international guidelines and an appeal for urgent law reform' (2) 2014 (77) THRHR 539, where it was noted that experience from other countries has shown that debtors fail in completing their payment plans where the repayment terms are larger than 3 years.

<sup>195</sup> See section 5.2.5 below.

#### 4.6 Conclusion

Debt relief in the form of the debt review process was introduced by the NCA with one of its objective being to ensure that a debtor meets his financial obligations in full.<sup>196</sup> As discussed above this debt relief remedy is available to an over-indebted debtor with debts falling within the scope of section 8 of the NCA and who has a regular income to make contributions in the event that his debts are re-arranged. The debt review process is initiated by the debtor in financial distress and only the court may declare the consumer debtor over-indebted. Upon being declared over-indebted the debtor's debts may *inter alia* be re-arranged. The discussion above has identified the lack of provision for discharge and debt review not being a bar to sequestration as the main shortcomings that might contribute to this debt relief option not providing adequate relief for consumer debtors in South Africa.<sup>197</sup>

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<sup>196</sup> See s 3 of the NCA.

<sup>197</sup> See 4.5 above.

## CHAPTER FIVE

### THE INTERFACE BETWEEN SOUTH AFRICAN INSOLVENCY AND CONSUMER CREDIT STATUTORY PROVISIONS

#### 5.1 Introduction

The lack of express statutory provisions regulating the relationship between the Insolvency Act and the NCA has far reaching consequences in our consumer insolvency system. This has led to a fair amount of litigation and has given rise to a series of significant court judgments. Both the NCA and the Insolvency Act regulate, amongst other things, matters relating to over-indebted debtors who are unable to fulfil their financial obligations.<sup>198</sup> The overlap between the two statutes results in an ever present danger that tension may arise at any given case.<sup>199</sup> The relationship between the two statutes has been the subject of recent discussion in several academic works. Inevitably, issues have surrounded the effect of the NCA's provision for debt review and debt restructuring on insolvency law in general and, more particularly, sequestration.<sup>200</sup>

Section 2 of the NCA provides that the Act must be construed in a manner which gives effect to section 3.<sup>201</sup> However, section 2 (7) of the NCA makes it clear that the provisions of the Act are not to be construed in a manner that amends, limits or repeals any provisions of any Act. The provisions of the NCA make no mention of the Insolvency Act and it has been argued that, if the legislature intended the provisions of the NCA to override the conflicting provisions of the Insolvency Act, it would have expressly stated such.<sup>202</sup> Section 172 of the NCA is the only provision that expressly amends the provisions of section 84 (1) of the Insolvency Act.<sup>203</sup> The interaction between the provisions of the NCA and the Insolvency Act has been evident in a number of cases in which the courts have been required to resolve disputes concerning the application of and interaction between these two statutes, particularly in the context of sequestration and debt review.<sup>204</sup> The main cases and the issues raised in them will be discussed below.

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<sup>198</sup> Chokuda, 'An application for debt review does not constitute an act of insolvency: FirstRand Bank v Janse Rensburg' (2013) 130 *SALJ* 5-18, 5.

<sup>199</sup> Chokuda (note 198 above) 5.

<sup>200</sup> Van Heerden and Boraine (note 171 above) 23.

<sup>201</sup> See 4.2 above.

<sup>202</sup> Van Heerden and Boraine (note 171 above) 36.

<sup>203</sup> Section 172 (2) of the NCA, see schedule 2 of the NCA.

<sup>204</sup> Chokuda (note 198 above) 5.

## 5.2 Sequestration and debt review

### 5.2.1 Voluntary surrender and debt review

The case of *Ex parte Ford* concerned three applications made by debtors for the sequestration of their estate. The liabilities of each of the three applicants consisted of debts owed to financial institutions or lenders in the form of loans or over-drafts.<sup>205</sup> It was common cause that their credit agreements fell within the definition of the NCA. The applicants stated in their affidavits that they considered debt counselling but expressed that debt re-arrangement would be financially impracticable because even after seven years of paying their debts in terms of a restructured payment plan, they would still not be clear of them. The court found the debts owed by the applicants to be disproportionate taking into account their modest income. This factor resulted in the court suspecting reckless lending on the part of the financial institutions. The court found it appropriate to reiterate the objectives of the NCA set out in section 3, one of which is to prevent reckless lending. The court then referred to its power in terms of section 85 of the NCA.<sup>206</sup> The court pointed out that an evaluation by the debt counsellor could have resulted in one or more of the credit agreements being declared reckless and consequently having them set aside or suspended.<sup>207</sup>

The court requested the applicants' counsel to justify why the over-indebtedness of the applicants should not be addressed using the debt review mechanism of the NCA instead of opting for the machinery of voluntary surrender.<sup>208</sup> Counsel for the applicants stated that the legislature was cognisant of the provisions of the Insolvency Act when it enacted the NCA. He argued that the legislature had not seen fit to make any changes to the provisions of the NCA regarding voluntary surrender and he further argued that section 85 of the NCA did not apply to voluntary surrender proceedings. He stated that section 85 of the NCA was dependent on the fulfilment of three requirements namely, the context of the court proceedings, the allegation of over-indebtedness in the proceedings by a consumer, and lastly, consideration by a court in those proceedings of the credit agreement.<sup>209</sup> He conceded that the first two requirements had been satisfied but argued that the third requirement was not met. He stated that the intention of the legislature was for section 85 only to apply to cases in which the terms of the credit agreement were being considered by a court in the

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<sup>205</sup> *Ex parte Ford* par 2.

<sup>206</sup> See 4.4 (note 180 above) for the discussion of the court's discretion in terms of section 85 of the NCA.

<sup>207</sup> Boraine & Van Heerden, 'To sequestrate or not to sequestrate in view of the National Credit Act 34 of 2005: a tale of two judgments' (2010) 13 (3) *PELJ* 84-508, 93.

<sup>208</sup> *Ex parte Ford* par 10.

<sup>209</sup> *Ex parte Ford* par 11.

context of resistance, on grounds of over-indebtedness, by a consumer debtor to a creditor's claim for performance in terms of a credit agreement.<sup>210</sup>

The court held that the language of section 85 was cast in very wide terms and that the provision that a court may invoke the section, despite any provision of law or agreement to the contrary, indicated the intended wide ambit for its operation.<sup>211</sup> The court further stated that the limitation of the provisions to proceedings in which a credit agreement is being considered does not imply that the proceedings in question are restricted only to those in which the enforcement of a credit agreement is the issue.<sup>212</sup> The court also emphasised that the provisions of section 4 of the Insolvency Act require the applicant for voluntary surrender to make full and frank disclosure of his assets and to satisfy the court that acceptance of the surrender of the estate in question will be to the advantage of creditors.<sup>213</sup>

The court was also not persuaded by the averments made by the applicants that debt re-arrangement was impracticable in their circumstances. The court stated that the NCA provided a wide remedial relief which can be accommodate any particular case. This included: disallowance of the recovery of the debt if such lending was reckless; staying the accrual of interest; and ranking liability. Further, the court found no evidence of proper considerations for debt counselling and the debt counsellor did not consider obtaining a declaration of reckless credit in respect of the debts.<sup>214</sup> Further, the court held that it was not prepared to exercise its discretion in favour of granting the application for voluntary surrender, due to the applicants' failure to properly explain why their credit agreement debts were not appropriate for administration under the NCA.<sup>215</sup> The court reminded that it had a duty to give effect to the public policy reflected in the NCA and public policy gives preference to rights of responsible credit grantors over reckless creditors and enjoins full satisfaction by the debtors on their financial obligations.<sup>216</sup>

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<sup>210</sup> *Ex parte Ford* par 11.

<sup>211</sup> *Ex parte Ford* par 12.

<sup>212</sup> *Ex Parte Ford* par 12.

<sup>213</sup> *Ex Parte Ford* par 13, See also *Boraine and Roestoff 2014 THRHR* (note 18 above) 355, where it was stated that South African case law has in many occasions emphasised the position it is not the main aim of the South African Insolvency Act to provide debt relief to debtors.

<sup>214</sup> *Ex parte Ford* par 18.

<sup>215</sup> *Ex Parte Ford* par 17.

<sup>216</sup> *Ex Parte Ford* par 20.

The court concluded by reminding debtors that the argument that they are entitled to choose the form of debt relief that suit their convenience, is a misdirected one, especially where the grant of the selected remedy is discretionary.<sup>217</sup> The court also remarked regarding the relationship between the NCA and the Insolvency Act, that a consonance exists between the object of the two statutes which is not to deprive creditors of their claims but merely to regulate the manner and extent of their payment.<sup>218</sup> The court was of the view that the circumstances in which the applicants were able to obtain credit from financial and money lending institutions and their failure to utilise the remedies under the NCA have been inadequately explained.<sup>219</sup> The court also held that the demonstrated monetary advantage in each of the applicant's case was marginal.<sup>220</sup> For these reasons the court concluded that the machinery of the NCA was more appropriate in these circumstances and consequently refused the applications.

Boraine and Van Heerden submitted that it was clear that the court wanted the applicants in this instance to get a proper determination on whether or not their credit agreements amounted to reckless credit, since the court did have a suspicion that this might have been the case.<sup>221</sup> It was further submitted that, in light of the decision of *Ex Parte Ford*, it was clear that over-indebtedness and reckless credit may play a significant role with regard to the applicant's ability to either choose voluntary surrender or compulsory sequestration to satisfy the court that sequestration is the option most beneficial to creditors where the debts consist largely of the credit agreements regulated by the NCA.<sup>222</sup> Boraine and Van Heerden agreed with the decision in *Ex Parte Ford* that the court has discretion to grant the sequestration order or not especially considering the advantage to creditors requirement, however they expressed that this decision indicated that some judges remained extremely pro-creditor oriented and the provisions of the NCA inherited this trait.<sup>223</sup>

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<sup>217</sup> *Ex Parte Ford* par 19.

<sup>218</sup> *Ex Parte Ford* par 21.

<sup>219</sup> *Ex Parte Ford* par 18.

<sup>220</sup> *Ex Parte Ford* par 18.

<sup>221</sup> Boraine and Van Heerden (note 207 above) 13.

<sup>222</sup> Boraine and Van Heerden (note 207 above) 13.

<sup>223</sup> Van Heerden and Boraine (note 171 above) 53.

## 5.2.2 Compulsory sequestration and debt review

### (a) General

As stated above sequestration proceedings may be initiated by a creditor who may apply to court to have his debtor's estate sequestrated.<sup>224</sup> The fact that it is a creditor, who applies for the compulsory sequestration of the debtor's estate, may influence the court to grant such order.<sup>225</sup> In compulsory sequestration creditors are not relieved of the burden of proving advantage to creditors, although the onus of proof is not as heavy as it is in a voluntary surrender application.<sup>226</sup>

As in a voluntary surrender application, creditors in a compulsory sequestration application may intervene in the proceedings for various reasons. A creditor may intervene where he is of the view that a consumer debtor who is over-indebted, but has not yet been for debt review by the time the sequestration proceedings are brought, should be referred to court where it can be determined which debt relief option would be in the interests of creditors. A creditor may also intervene by arguing that a consumer, who is already subject to a debt restructuring order and is maintaining payments in terms of it, should remain subject to such order because this would serve the advantage of creditors better than sequestration.<sup>227</sup>

### (b) Debt review not a bar to sequestration

The question whether a sequestration proceeding amounts to enforcing a credit agreement was raised as an issue in *Investec v Mutemeri*.<sup>228</sup> In this case, the applicants applied for the compulsory sequestration of the joint estate of the respondents. The respondents opposed the application, arguing, *inter alia*, that, because the applicants' claims against them were based on credit agreements within the meaning of the NCA, the application for the sequestration of their estates was barred under the NCA.<sup>229</sup> The respondents were essentially arguing that an application for compulsory sequestration amounts to the enforcement of a debt, which is barred in terms of sections 129 (1) (b) and 130 (1) (b) of the NCA.

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<sup>224</sup> See 2.2 above.

<sup>225</sup> Van Heerden and Boraine (note 171 above) 52.

<sup>226</sup> Van Heerden and Boraine (note 171 above) 45.

<sup>227</sup> Van Heerden and Boraine (note 171 above) 52.

<sup>228</sup> See note 8 above.

<sup>229</sup> *Investec v Mutemeri* par 1.

The court held that the real question to be answered in this case was whether an application for sequestration of a consumer's estate, that is based on the applicant's claim against the consumer in terms of a credit agreement, is an application 'for an order to enforce a credit agreement' within the meaning of section 130 (1).<sup>230</sup> In answering this question, the court referred to the case of *Estate Logie v Priest* ('*Estate Logie*'),<sup>231</sup> where the court expressed that there is 'doubt that in an application for compulsory sequestration the creditor seeks payment of the debt from his debtor.'<sup>232</sup> In *Investec v Mutemeri*, the court clarified that whether an application for sequestration constitutes an application for an order to enforce a credit agreement, within the meaning of section 130 (1) of the NCA, depends on the nature of the relief sought by the creditor, and not on the sequestrating creditor's underlying motive in bringing the application.<sup>233</sup> The court stated that, whatever a credit provider's underlying motive, the application is not barred by section 130 (1) unless it is an application for an order 'to enforce a credit agreement'.<sup>234</sup>

The court relied on precedent established in the case of *Collet v Priest*<sup>235</sup> where De Villiers CJ explained thus why it could not be said that an application for sequestration was a proceeding by which one party sued for or claimed something from another:<sup>236</sup>

'The order placing a person's estate under sequestration cannot fittingly be described as an order for a debt due by the debtor to the creditor. Sequestration proceedings are instituted by a creditor against a debtor not for the purpose of claiming something from the latter, but for the purpose of setting the machinery of the law in motion to have the debtor declared insolvent.'<sup>237</sup>

In *Investec v Mutemeri*, the court concluded that the rationale of these judgments is equally applicable to the proper interpretation of section 130(1) of the NCA, which applies only to an application to court 'for an order to enforce a credit agreement'.<sup>238</sup> Trengove AJ unequivocally stated that section 130 (1) of the NCA does not apply to an application by a credit provider for the sequestration of a consumer's estate based on a claim in terms of a

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<sup>230</sup> *Investec v Mutemeri* par 26.

<sup>231</sup> 1926 AD 312.

<sup>232</sup> *Investec v Mutemeri* par 27.

<sup>233</sup> *Investec v Mutemeri* par 28.

<sup>234</sup> *Investec v Mutemeri* par 28.

<sup>235</sup> 1931 AD 290.

<sup>236</sup> *Investec v Mutemeri* par 29 with reference to *Collett v Priest* 299.

<sup>237</sup> *Investec v Mutemeri* par 29.

<sup>238</sup> *Investec v Mutemeri* par 31.

credit agreement entered into between them. Such an application is not one for an order enforcing the credit provider's claim against the consumer

The case of *Investec v Mutemeri* also dealt with the issue whether a creditor who has received a notice that a debtor has applied for debt review may proceed with the application for a sequestration order of the debtor's estate. The respondents invoked the provisions of section 88 (3) of the NCA which provides, *inter alia*, that a credit provider, who receives notice of a consumer's application for debt review in terms of s 86 (4) (b) (i), may not exercise or enforce by litigation or other judicial process any right or security under a credit agreement between the credit provider and the consumer, until certain conditions have been met.<sup>239</sup> It was held in this respect that an application for sequestration did not qualify as litigation or other judicial process to enforce any right under a credit agreement.<sup>240</sup> Consequently, in view of this decision, it appears that a credit provider may apply for compulsory sequestration while the consumer is under debt review.<sup>241</sup>

The decision in *Investec v Mutemeri* was confirmed by the SCA in *Naidoo v Absa Bank Ltd*,<sup>242</sup> that sequestration does not amount to legal proceedings to enforce an agreement, as envisaged by section 129 read with section 130 (3) of the NCA.<sup>243</sup> The sequestration order in this case stemmed from the appellant's failure to meet payments due to the respondent under instalment sale agreements relating to six motor vehicles and two home loan agreements.<sup>244</sup> It was common cause that the credit agreements fell within the definition of section 8 of the NCA.<sup>245</sup> The appellant contended that the respondent was not competent to have instituted proceedings for his sequestration before complying with the procedure provided for in section 129 (1) (a) of the NCA.<sup>246</sup>

The court held that the language employed in section 130 (3) (a) does not extend the remit of section 129 to sequestration proceedings but simply alludes to the situation that, where a

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<sup>239</sup> S 88 (3) NCA.

<sup>240</sup> *Investec v Mutemeri* par 31.

<sup>241</sup> Maghembe, 'The appellate division has spoken: sequestration proceedings do not qualify as proceedings to enforce a credit agreement under the National Credit Act 34 of 2005: *Naidoo v Absa Bank* 2010 4 SA 597 (SCA)' (2011) 15 *PELJ* 171-226, 175.

<sup>242</sup> See note 8 above.

<sup>243</sup> *Naidoo v Absa* par 4.

<sup>244</sup> *Naidoo v Absa* par 1.

<sup>245</sup> *Naidoo v Absa* par 1

<sup>246</sup> *Naidoo v Absa* par 2.

credit provider decides to institute proceedings to enforce the agreement, he may do so only after having complied with the procedure set out in section 129 (1) (a).<sup>247</sup> In the result, creditors do not need to comply with the requirements set out in section 129 (1) (a) before instituting sequestration proceedings against a consumer, because such proceedings are not proceedings to enforce a credit agreement.<sup>248</sup>

In a more recent case of *FirstRand Bank v Kona and others*,<sup>249</sup> the SCA set aside the North Gauteng High Court's decision, that an application by a creditor for the sequestration of his debtor's estate constituted 'other judicial process' in terms of section 88 (3), and that the debt re-arrangement order, unless set aside by a competent court, barred any sequestration application by a creditor.<sup>250</sup> The SCA re-affirmed the position in *Naidoo v Absa* and *Investec v Mutemeri* that, sequestration proceedings by a creditor against the estate of his debtor was not tantamount to 'litigation or other judicial process within the meaning of section 88 (3)'.<sup>251</sup> Further, the court held that recognising that the provisions of section 88 (3) did not constitute a bar to the institution of sequestration proceedings, implied that the existence of a debt re-arrangement order was immaterial to the application for sequestration of the debtor's estate, unless the debt re-arrangement order was raised as a circumstance for the court to exercise its discretion in favour of the debtor.<sup>252</sup>

In light of the above cases and, in particular, the more recent decision of *FirstRand Bank v Kona*, it is clear that in the absence of any legislative intervention, the position established in the case law regarding debt review not barring sequestration will remain. Therefore, although the international principles makes a recommendation that creditors should be prohibited from pursuing the debtor during the insolvency process,<sup>253</sup> consumer debtors are not in fact protected by the NCA against creditors seeking to sequester their estate.

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<sup>247</sup> *Naidoo v Absa* par 7.

<sup>248</sup> Kupiso, 'Can debt enforcement procedures be circumvented by insolvency proceeding?' 2011 *De Rebus* (Nov) 26-27, 27.

<sup>249</sup> 2003/2014 [2015] ZSCA 11.

<sup>250</sup> *FirstRand Bank v Kona* par 10.

<sup>251</sup> *FirstRand Bank v Kona* par 14.

<sup>252</sup> *FirstRand Bank v Kona* par 15.

<sup>253</sup> Steyn submits that that the phrase 'insolvency process' which is used in the first principle envisages the consumer debt relief process, which includes both liquidation and rehabilitation process. See note 5 218.

(c) Application for debt review an act of insolvency?

Until recently, a debtor who gave notice in writing to any of his creditors that he was unable to pay any of his debts was deemed to have committed an act of insolvency in terms of section 8 (g).<sup>254</sup> In *FirstRand Bank Ltd v Evans*<sup>255</sup> and in *FirstRand Bank v Janse Van Rensburg*,<sup>256</sup> the courts were asked to pronounce on the question whether an application by the debtor to be placed under debt review in terms of section 86 of the NCA constitutes an act of insolvency in terms of section 8 (g) of the Insolvency Act. In *FirstRand Bank v Evans*, the case was concerned with an application for the provisional sequestration of the estate of the respondent. Evans was indebted to the bank for an amount of R2.8 million obtained as a loan secured by two mortgage bonds passed over for his immovable properties.<sup>257</sup> The bank bought the application on the ground that Evans committed an act of insolvency.<sup>258</sup> Evans had applied for debt review in terms of the NCA and had addressed the letter to FNB informing them that he was under debt review.

The court stated that a proper approach to be adopted in establishing whether a letter such as the one written by Evans constituted a notice of inability to pay in terms of section 8 (g) of the Insolvency Act is by considering how it would be understood by a reasonable person in the position of the creditor receiving the letter.<sup>259</sup> The court held that the notice, when received by FNB, conveyed to FNB that Evans could not at present time pay in accordance with his commitment. However, counsel for the respondent argued that the letter conveyed an intention to have the respondent's debts re-arranged as contemplated by section 86 of the NCA.<sup>260</sup> The court argued that although the submission by the respondent's counsel was correct it did not alter the fact that the respondent wrote a letter unequivocally conveying to FNB that he was at that time unable to pay his debts.<sup>261</sup> Counsel for the respondent then submitted that any debtor who informs his creditor that he has applied for debt review or that he is in the process of debt review would result in his creditor alleging a commission of an act of insolvency.<sup>262</sup>

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<sup>254</sup> S 8 (g) of the Insolvency Act.

<sup>255</sup> See note 8 above.

<sup>256</sup> See note 8 above.

<sup>257</sup> *Evans* par 1.

<sup>258</sup> *Evans* par 1.

<sup>259</sup> *Evans* par 14.

<sup>260</sup> *Evans* par 21.

<sup>261</sup> *Evans* par 21.

<sup>262</sup> *Evans* par 21.

The court referred to *Madari v Cassim*,<sup>263</sup> where it was held that a debtor who gives notice to his creditors of an intention to apply for an administration order in terms of section 74 of the MCA did commit an act of insolvency.<sup>264</sup> The court relied on *Madari v Cassim* and held that it failed to see why the provisions of section 8 (g) of the Insolvency Act should be interpreted differently as a result of the enactment of the NCA and if the legislature intended to qualify section 8 (g) it would have expressly done so.<sup>265</sup> Therefore, the court concluded that a letter informing a creditor of the debtor's inability to pay his debts, together with a request to pay the debt over a period of time in smaller instalments would constitute an act of insolvency in terms of section 8 (g) of the Insolvency Act.<sup>266</sup>

In *FirstRand Bank v Janse Van Rensburg*, the court did not follow the approach set out in *Evans*. It was alleged that the respondents committed an act of insolvency by applying for debt review in terms of the NCA.<sup>267</sup> The bank relied on the consumer profile report issued by a credit bureau which stated that each of the respondents had applied for debt review.<sup>268</sup> The issue in this case was whether an application for debt review constituted an act of insolvency and whether the applicant had established that such an act has been committed.<sup>269</sup> Counsel for the applicant submitted that an application for debt review in terms of section 86 of the NCA does not constitute an act of insolvency in terms of section 8 (g) of the Insolvency Act. He relied on the judgement by Wallis J (as he then was) in *Evans*, where the court pronounced that an application for an administration order was an act of insolvency.<sup>270</sup>

The court dismissed counsel's submission and held that *Evans* was not authority that the application for debt review in terms of the NCA fell within the scope of section 8 (g) of the Insolvency Act.<sup>271</sup> Further, the court stated that the judge was not called upon to decide whether the application for debt review in terms of the NCA constituted an act of insolvency and he made no such finding.<sup>272</sup> The court stated that the judge's remarks that a debt review was not a novel position since applicants for administration orders are in precisely the same

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<sup>263</sup> See note 161 above.

<sup>264</sup> *Evans* par 21.

<sup>265</sup> *Evans* par 21.

<sup>266</sup> *Evans* par 22.

<sup>267</sup> *Janse van Rensburg* par 1.

<sup>268</sup> *Janse van Rensburg* par 5.

<sup>269</sup> *Janse van Rensburg* par 17.

<sup>270</sup> *Janse van Rensburg* par 8.

<sup>271</sup> *Janse van Rensburg* par 16

<sup>272</sup> *Janse van Rensburg* par 16.

position was held in *obiter* and the judge did not find that an application for debt review in terms of the NCA *ipso facto* constituted an act of insolvency.<sup>273</sup> Thus the court took the view that *Madari v Cassim* was not authority for such a proposition.<sup>274</sup>

The court drew a distinction between the facts in *Madari v Cassim* and the case before it and held that the decision in *Madari* did not deal with whether a notice of intention to apply for an administration order constituted an act of insolvency, but that the issue whether an act of insolvency has been committed, appeared to have been common cause.<sup>275</sup> The court also further provided a distinction between the two procedures, namely, administration and debt review. The court stated that the administration order procedure is akin to a ‘modified form of insolvency’ which is applicable to small estates in which a *concursum creditorum* is created.<sup>276</sup> The application to be placed under administration entails a submission by a debtor of his detailed statement of affairs, confirmation of the correctness of the information under oath, a motivation as to the basis of his inability to meet his financial obligations and most importantly, delivery of a notice of the application to creditors.<sup>277</sup> Thus the application itself meets the requirements of section 8 (g) of the Insolvency Act because a notice is delivered to a creditor in which a debtor states his inability to meet his financial obligations.<sup>278</sup>

On the other hand the procedure to apply for debt review in terms of the NCA is a different procedure to section 74 of the MCA. The procedure for debt review is an application made by a consumer debtor to a registered debt counsellor. A debtor is required to submit a particular form and supporting documents and information to the debt counsellor and upon receipt of the application the debt counsellor is required to issue a notice to all the listed creditors informing that an application for debt review has been received.<sup>279</sup> Thus the application submitted by the debtor and the information contained in the form is not provided to the credit provider.<sup>280</sup> The court held that, if the words of the notification do not convey an unequivocal statement of inability to meet a debtor’s obligation, the fact that the creditor may

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<sup>273</sup> *Janse van Rensburg* par 19.

<sup>274</sup> *Janse van Rensburg* par 19.

<sup>275</sup> *Janse van Rensburg* par 21

<sup>276</sup> *Janse van Rensburg* par 21.

<sup>277</sup> *Janse van Rensburg* par 27.

<sup>278</sup> *Janse van Rensburg* par 27.

<sup>279</sup> *Janse van Rensburg* par 27.

<sup>280</sup> *Janse van Rensburg* par 27.

have construed the notice in that manner does not render the notice to be one in terms of section 8 (g) of the Insolvency Act.<sup>281</sup>

The written notice which the applicant relied on was one which was communicated by a credit bureau rather than by the debtor.<sup>282</sup> The court found that there was nothing suggesting that the credit bureau was authorised by the respondents to make declaration on behalf of the respondents nor did they hold such authority in regard to the affairs of the respondents.<sup>283</sup> The court in support of its argument referred to *Eli Spilikin (Pty) Ltd v Mather*,<sup>284</sup> where it was held that if an agent on behalf of a debtor, writes a letter which amounts to an act of insolvency in terms of section 8 (g) of the Act, he the agent must be satisfied that the principal knew that the letter was being written in those terms and consented to it being so written.<sup>285</sup> In light of the above, the court found that the applicant failed to establish that the respondents committed an act of insolvency.

Chokuda submitted that the *FirstRand Bank v Janse van Rensburg* judgment was significant in our law as it clarified the contentious interface between the provisions of the debt review and sequestration.<sup>286</sup> Although the decision in *Janse van Rensburg* may have settled the uncertainty of whether the application for debt review amounted to an act of insolvency, a possibility of another challenge to these provisions always existed, and this was evidence of the lacuna that was ever present which required legislative intervention. In the recent case of *De Klerk*,<sup>287</sup> the Constitutional Court dealt with an appeal that raised the question of whether a debt re-structuring proposal in terms of section 86 (1) of the NCA sent to a creditor on the instructions of a debtor was an act of insolvency thus allowing a creditor to initiate sequestration proceedings.<sup>288</sup> The Constitutional Court was of the view that since the applicant, Mr De Klerk was in fact factually insolvent it should not interfere with findings of the high court. Further, the court avoided to deal with this issue on the basis that, a legislative amendment to the NCA was in the process of being enacted, at the time the application was heard, and this amendment clarified the issue in dispute in this case.<sup>289</sup>

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<sup>281</sup> *Janse van Rensburg* par 28.

<sup>282</sup> *Janse van Rensburg* par 30.

<sup>283</sup> *Janse van Resnburg* par 32.

<sup>284</sup> 1970 (4) SA 22 (E).

<sup>285</sup> *Janse van Rensburg* par 32.

<sup>286</sup> Chokuda (note 198 above) 5.

<sup>287</sup> *De Klerk* (note 10 above).

<sup>288</sup> *De Klerk* par 1.

<sup>289</sup> *De Klerk* par 20.

As Steyn had correctly submitted, perhaps clarification by the Supreme Court of Appeal or the legislature may finally put this issue to rest. Steyn also made a notable submission that precedent relevant to application for administration orders in terms of section 74 of the MCA should not be applied automatically to cases concerning the NCA and its relationship with the provisions of the Insolvency Act. More recently, the call for legislative intervention has been addressed by the enactment of the new section 8A of the Insolvency Act. Section 8A appears to have been enacted to address some of the shortcomings of the NCA and the Insolvency Act in not providing specifically for the relationship between them, the new section provides that a debtor who applies for debt review has not commit an act of insolvency.

Otto and Otto submitted that the exact influence of the insolvency law on the NCA, and vice versa, is something that still has to be worked out by courts.<sup>290</sup> It remains to be seen whether the new section 8A of the Insolvency Act, will in fact adequately resolve some of the issues between the provisions of the NCA and the Insolvency Act, following the courts' future application of this legislative amendment.

### **5.3 Conclusion**

The legislature, when enacting the NCA, failed to make express provision to exclude the application of the Insolvency Act or for the NCA to prevail. As a result, conflict has arisen between some of the provisions of the NCA and the Insolvency Act. This paper has identified some of the issues which present a conflict in the application of these two statutes. The main issue is that the estate of a debtor who applies for or is subjected to debt review is not protected from sequestration by his creditors. The second issue was the application for debt review being construed as an act of insolvency in terms of section 8 (g) of the Insolvency Act, thus allowing a creditor to apply for the sequestration of the estate of his debtor. This issue has been recently resolved by the enactment of section 8A of the Insolvency Act. In terms of the provisions of section 8A a debtor who has applied for debt review is no longer deemed to have committed an act of insolvency. This development is a positive one as we have seen courts grapple and come to different outcomes regarding this issue. It would have however been interesting to know how the Constitutional Court would have answered this question if it was not for the enactment of the section 8A.

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<sup>290</sup> Otto and Otto, *National Credit Act explained* (note 190 above) 134.

Cases such as *Investec v Mutemeri*, *Naidoo v Absa*, *First Rand Bank v Evans*, *First Rand Bank v Janse van Rensburg* and *De Klerk v Wes Korporatief Bpk* have highlighted the conflict between the provisions of the NCA and the Insolvency Act. The court in *Ex Parte Ford* settled the issue in respect of debt review and voluntary surrender by making it clear that a debtor who is over-indebted does not have a choice between using the remedy of the Insolvency Act by applying for the voluntary surrender of his estate or invoking provisions of the NCA by applying for debt review.<sup>291</sup> Further, the case of *Investec v Mutemeri*, and the two SCA decisions in *Naidoo v Absa* and *First Rand Ltd v Kona* settled the question of whether an application for debt review was a bar to sequestration.<sup>292</sup> With the current position as set out in these three cases, the estate of a debtor who applies for debt review is therefore not protected from sequestration by his creditors. Finally the court in *Janse van Rensburg* held that application for debt review did not amount to act of insolvency<sup>293</sup> and the new section 8A of the Insolvency Act has affirmed this position.

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<sup>291</sup> See 5.2.1 above.

<sup>292</sup> See 5.2.2 (b) above.

<sup>293</sup> See 5.2.2 (c) above.

## CHAPTER 6

### Consumer Debt Relief in Foreign Jurisdictions

#### 6.1 Introduction

Consideration of foreign debt relief systems may prove useful in helping improve our debt relief system. This paper identifies three issues that require legislative intervention so as to provide adequate debt relief options to consumer debtors in South Africa. In earlier chapters of this paper it was submitted that debt relief options in South Africa are not capable of addressing the modern changes of consumer debtors and the credit industry. The three shortcomings in our consumer insolvency system which were highlighted are: the strict requirement of advantage to creditors; lack of discharge provisions in the two debt relief options other than sequestration; and lastly, debtors having no choice in the debt relief option they seek to use during their period of financial dilemma. Further, a creditor is not barred from applying for the sequestration of the estate of a debtor who has applied for, or is subject to, debt review.

This chapter will discuss consumer debt relief options in the United States of America and in England and Wales to determine to what extent their provisions can be incorporated in our law to provide adequate debt relief for consumer debtors in South Africa. This chapter will look at how these jurisdictions have addressed the issues already identified in earlier chapters as being problematic in South Africa.

The United States of America has been chosen for its unique ‘debtor-friendly’ approach in its debt relief options, as they are premised on the principle of affording debtors a ‘fresh start’. South Africa’s consumer insolvency law has been criticised on the basis of its being too creditor-orientated. Therefore, a glance at consumer debt relief options available for consumers in the United States of America may provide valuable insights into the types of provisions which may be included in our own consumer insolvency legislation. England and Wales, as a jurisdiction, has been chosen because, despite the strong Roman-Dutch roots of South African insolvency law, aspects of the Insolvency Act 24 of 1936 also reflect strong English law influences. Comparing the position in each jurisdiction, particularly in light of the changes brought about in the law in response to consumer debt problems which arose in the wake of global economic recessions and crises, may guide legislators in South Africa in relation to the introduction of revised or new statutory solutions here.

## 6.2 United States of America

### 6.2.1 Background

The American bankruptcy laws have their origin in English law.<sup>294</sup> Early English bankruptcy laws were designed to afford remedies only to *creditors* and punished debtors who sought any form of debt relief by imprisonment.<sup>295</sup> Debtors were offered better protection with the enactment of the Bankruptcy Act of 1841 which extended its application not just to merchants and bankers, but all debtors.<sup>296</sup> The American bankruptcy law system has been regarded as unique because traditionally, most bankrupt regimes in western countries, including South Africa, places emphasis on the advantage to creditors requirement whereas, the American system is premised on principle of ‘fresh start’.<sup>297</sup> This is in order to provide honest debtors with an opportunity to shed their debts, thereby allowing them a fresh start.<sup>298</sup> In *Local Loan Co v Hunt*,<sup>299</sup> the court held:

‘the purpose of the Act has been again and again emphasized by the courts as being of public as well as private interest, in that it gives to the honest but unfortunate debtor who surrenders for distribution the property which he owns at the time of bankruptcy, a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt’.<sup>300</sup>

On October 1979, the Bankruptcy Reform Act of 1978 (the Bankruptcy Code) became effective and now regulates the American bankruptcy system.<sup>301</sup> The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (‘BAPCPA’) has brought extensive amendments to the Bankruptcy Code. These amendments were intended to curb abuse by debtors and create a bankruptcy system which reflected a more appropriate balance between the interests of creditors and debtors.

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<sup>294</sup> Boraine and Roestoff, ‘American Consumer Bankruptcy Law: Lessons for South Africa’ 2000 *Obiter* 33 and 241, 26.

<sup>295</sup> Boraine and Roestoff (note 294 above) 36.

<sup>296</sup> Boraine and Roestoff (note 294 above) 38.

<sup>297</sup> Evans, ‘A brief explanation of consumer bankruptcy and aspects of bankruptcy estate in the United States of America’ 2010 *XLIII CILSA* 337-351,337.

<sup>298</sup> Evans (note 297 above) 346.

<sup>299</sup> *Local Loan Co v Hunt* 292 U.S 234 (1934).

<sup>300</sup> *Local Loan Co v Hunt*.

<sup>301</sup> Calitz, ‘Development in the United States’ Consumer bankruptcy Law: A South African perspective’ 2007 *Obiter* 397-417, 398.

Having considered briefly the history of American bankruptcy and the developments to date, this paper will now focus on the specific debt relief options available under chapter 7 and chapter 13 of the Bankruptcy Code. Chapter 7 provides for the liquidation of the estate of the debtor and chapter 13 provides for the adjustment of debts of an individual debtor, who has a regular income which he can apply to pay his debts in terms of a repayment plan.<sup>302</sup>

### 6.2.2 Chapter 7 (Liquidation)

Bankruptcy proceedings are often referred to as ‘straight’ bankruptcy or ‘liquidation’ bankruptcy cases.<sup>303</sup> In theory, debtors under the chapter 7 liquidation proceedings give up all their property in exchange for relief in the form of a discharge from their debts.<sup>304</sup> Bankruptcy cases commence with the filing of a petition that may be either voluntary or involuntary.<sup>305</sup> In a voluntary chapter 7 petition a debtor list his creditors and provide a schedule of assets, and liabilities and income and expenditure as well as other documents that enable creditors and the trustee to verify the accuracy of the information enclosed in the petition.<sup>306</sup>

BAPCPA introduced certain new requirements that must be fulfilled before chapter 7 relief is granted.<sup>307</sup> It introduced a means test and also a preliminary enquiry to establish and investigate whether the debtor’s income multiplied by 12, is below the median family income of the state in which the debtor resides.<sup>308</sup> If it is, the debtor will not be required to undergo the means test.<sup>309</sup> If the debtor’s income exceeds the median family income of his state, he is required to undergo the means test. Any debtor who fulfils the requirements of the means test of section 707 (b) (2) can file for bankruptcy. If the debtor does not meet the requirements of the means test, this would result in the court dismissing the petition under this chapter.

The commencement of chapter 7 proceedings results in the automatic creation of an estate as set out in section 541 of the Code.<sup>310</sup> In terms of section 362 of the Code, the filing of a bankruptcy petition also imposes an automatic stay, barring all civil actions involving the

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<sup>302</sup> Evans (note 297 above) 341.

<sup>303</sup> Ferriell and Janger, *Understanding bankruptcy* (2<sup>nd</sup> edition) 2007, LexisNexis 603.

<sup>304</sup> Ferriell and Janger (note 303 above) 603.

<sup>305</sup> Boraine and Roestoff, (note 294 above) 47.

<sup>306</sup> Ferriell and Janger (note 303 above) 605.

<sup>307</sup> Evans (note 297 above) 406.

<sup>308</sup> S 707 (b) (6) of the Bankruptcy Code.

<sup>309</sup> S 707 (b) (6) of the Bankruptcy Code.

<sup>310</sup> S 541(a) of the Bankruptcy Code.

debtor and his property.<sup>311</sup> The automatic stay is a prominent feature in the Bankruptcy Code, protecting the debtor against certain actions by the creditor, most importantly precluding creditors from instituting all judicial and administrative proceedings as well as most informal actions a creditor might take in an effort to collect.<sup>312</sup> The automatic stay is not permanent and ends when the bankruptcy case ceases.<sup>313</sup>

At the end of the case, the debtor receives a fresh start.<sup>314</sup> The Bankruptcy Code contains a number of discharge rules each depending on the type of bankruptcy proceeding involved.<sup>315</sup> The significance of discharge is that a debtor is released and is no longer liable to pay pre-petition debts.<sup>316</sup> In certain circumstances a debtor will not receive a discharge this includes where *inter alia*, the debtor is not an individual; the debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate has transferred, removed, destroyed, or concealed or has permitted to be transferred, removed, destroyed, mutilated, or concealed- property of the debtor, within one year before the date of the filing of the petition; or property of the estate, after the date of the filing of the petition.<sup>317</sup> Debts such as tax debts; debts fraudulently incurred; unsecured debts; family obligations; and wilful and malicious injury are not discharged.<sup>318</sup>

### **6.2.3 Chapter 13 (Repayment plan)**

Chapter 13 is an alternative to bankruptcy in the form of a repayment plan. A chapter 13 bankruptcy petition may be filed by the debtor himself or by the debtor and his spouse. In order to be eligible for filing under chapter 13 the debtor must have a stable source of income and have debt liability not exceeding \$1,149,525 in secured claims and \$383,175 in unsecured claims.<sup>319</sup> Chapter 13 plans have three essential provisions. Section 109 of the Code requires that the plan:

(a) 'shall provide for the submission of all or such portion of future earnings or other future income of the debtor to the supervision and control of the trustee as is necessary for the execution of the plan;

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<sup>311</sup> Ferriell and Janger (note 303 above) 257.

<sup>312</sup> Ferriell and Janger (note 303 above) 259.

<sup>313</sup> Ferriell and Janger (note 303 above) 275.

<sup>314</sup> Ferriell and Janger (note 303 above) 257.

<sup>315</sup> S 524 of the Bankruptcy Code.

<sup>316</sup> S 727 of the Bankruptcy Code.

<sup>317</sup> S 727 of the Bankruptcy Code. See s 524 of the Bankruptcy Code for the effect of a discharge.

<sup>318</sup> S 523 of the Bankruptcy Code.

<sup>319</sup> S 109 of the Bankruptcy Code.

(b) shall provide for the full payment, in deferred cash payments, of all claims entitled to priority under the section; and

(c) if the plan classifies claims, shall provide the same treatment for each claim within a particular class.<sup>320</sup>

Creditors in the chapter 13 plan do not participate nor vote on whether to accept the plan, the debtor is the only one with the right to submit a plan.<sup>321</sup> In most instances a debtor files his plan simultaneously with his petition.<sup>322</sup> The plan is filed 15 days after the petition and in addition, a debtor must file various documents, including schedules of assets and liabilities, a statement of the current income and expenditures, and a statement of affairs.<sup>323</sup> The debtor is required to commence making payments pursuant to the plan not later than 30 days after the date of filing of the plan, or the order for relief, whichever is earlier, unless the court orders otherwise.<sup>324</sup>

In chapter 13 cases, the debtor pays his future income to a trustee for three to five years and the trustee thereafter distributes it to creditors pursuant to the court-approved payment plan.<sup>325</sup> Once the chapter 13 plan is confirmed,<sup>325</sup> it binds the debtor and all creditors.<sup>326</sup> The debtor must be able to abide by the plan.<sup>327</sup> The debtor may modify the plan at any time before it is confirmed provided it still meets the requirements of the section.<sup>328</sup>

If a debtor is not eligible for chapter 13 as a result of having too much disposable income, he cannot be compelled to file to file a petition under chapter 7.<sup>329</sup> A debtor may convert his case voluntarily from chapter 13 to chapter 7 and a waiver of this right is null and void.<sup>330</sup> In certain circumstances such as: when a debtor fails to make payments under the confirmed plan; there is an unreasonable delay by the debtor that is prejudicial to creditors; and failure to file a plan timeously, the court, can convert the case to liquidation under chapter 7 or may dismiss the case under chapter 13, whichever is in the best interests of creditors and the estate.<sup>331</sup>

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<sup>320</sup> S 1322 of the Bankruptcy Code.

<sup>321</sup> Ferriell and Janger (note 303 above) 648.

<sup>322</sup> Ferriell and Janger (note 303 above) 643.

<sup>323</sup> S 1322 Bankruptcy Code.

<sup>324</sup> S 1322 of the Bankruptcy Code 1326.

<sup>325</sup> Ferriell and Janger (note 303 above) 641.

<sup>326</sup> Boraine and Roestoff (note 317) 53.

<sup>327</sup> Boraine and Roestoff (note 294 above) 53.

<sup>328</sup> S 1323 of the Bankruptcy Code.

<sup>329</sup> Ferriell and Janger (note 303 above) 644.

<sup>330</sup> S 1307 of the Bankruptcy Code.

<sup>331</sup> S 1307(c) of the Bankruptcy Code.

Section 362 (a) of the Bankruptcy Code provides that a petition filed under any debt relief chapter of the Code stays any judicial and administrative actions by the creditor. Automatic stay is one effect of chapter 13 and the debtor may get to keep his home. Another effect of chapter 13 is discharge. Unlike chapter 7, the scope of discharge under chapter 13 depends on whether the debtor successfully completes his plan.<sup>332</sup> The Congress gives an incentive to debtors who choose chapter 13 over chapter 7 in a form of broader discharge upon the completion of a chapter 13 plan.<sup>333</sup> Section 1328 of the Code discharges all debts owed by the debtors except for the following: long terms debts; which are claims on which the latest payment is due after the due date for the final payment under the plan; tax debts; debts incurred through fraud; student loans; and criminal restitution orders or fines.<sup>334</sup> In addition, section 1328 precludes a debtor from receiving a discharge if the debtor has been discharged previously under chapter 7, 11, or 12 in a bankruptcy case filed within four years preceding the date of the order for relief under chapter 13.<sup>335</sup> It may be noted that the bankruptcy laws in America make no provisions for debt relief orders for consumer debtors with no income and no assets (NINA).

## **6.3 England and Wales**

### **6.3.1 Background**

Originally, bankruptcy laws in England were extremely pro-creditor. Consumer debtors, who became insolvent, could claim no relief from the common law. Procedures to enforce payment of debts through seizure and imprisonment of the debtor as well the sale of their property applied even to those debtors who were honest but became insolvent through misfortune.<sup>336</sup> In the 19<sup>th</sup> century England introduced a series of bankruptcy legislation which laid the foundation of the modern law of bankruptcy, as we know it today.<sup>337</sup> During this period England experienced a lot of changes in their bankruptcy laws and the coming into effect of the Bankruptcy Act 1883, afforded the law of personal insolvency which is still recognisable today.<sup>338</sup>

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<sup>332</sup> Ferriell and Janger (note 303 above) 515.

<sup>333</sup> Ferriell and Janger (note 303) 515.

<sup>334</sup> S 1328 of the Bankruptcy Code.

<sup>335</sup> S 1328 Bankruptcy Code, chapter 11 is the reorganisation chapter. Chapter 11 seeks to enable financially troubled business to capture and preserve their 'going concern value'. This is similar to our own Business rescue provisions. Chapter 12 is a reorganisation proceeding designed to assist financially troubled 'family farmers'

<sup>336</sup> Fletcher (note 13 above) 10.

<sup>337</sup> Fletcher (note 13 above) 10.

<sup>338</sup> Fletcher (note 13 above) 11.

The consumer insolvency law in England and Wales offers two debt relief options for consumer debtors. These debt options are divided into formal options which are under the Insolvency Act 1986, and informal options available which are non-statutory.<sup>339</sup> The coming into effect of the Enterprise Act 2002 has resulted in the insolvency system in England and Wales being categorised as debtor friendly.<sup>340</sup> The paper will only discuss the formal statutory debt relief options available to consumer debtors in England and Wales. The options include the Bankruptcy process, individual voluntary arrangements (IVAs), court county administrative orders (CCAOs), and debt relief orders (DROs) for no income and no assets (NINA) debtors.

### **6.3.2 Bankruptcy**

Bankruptcy is regulated by the provisions in Part IX of the Insolvency Act 1986. Section 264 of the Insolvency Act 1986 lists those who can bring a petition of bankruptcy against an individual. The list includes:

- (i) individual creditors;
- (ii) the debtor himself;
- (iii) the temporary administrator;
- (iv) the supervisor of, or any person other than the individual who is for the time being bound by a voluntary arrangement proposed by the individual and approved under Part VIII; and
- (v) the Official Petitioner or any person specified in the order.<sup>341</sup>

The requirements to present a petition for Bankruptcy are set out in section 265 of the Insolvency Act 1986 and, *inter alia*, require a debtor to be domiciled in England and Wales and to be present in England and Wales when the petition is presented.<sup>342</sup> The bankruptcy order stays individual enforcement by creditors against the debtor and prevents a debtor from creditor harassment. At the expiration of the bankruptcy period the debtor receives discharge as provided for in section 279 of the Insolvency Act 1986. The Enterprise Act 2002 provides for debtors entering bankruptcy to have their debts automatically discharged after one year,

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<sup>339</sup> Walters, 'Individual Voluntary Arrangements: A Fresh Start for Salaried Consumer Debtors in England and Wales' *International Insolvency Review* 5 volume 18 (2009) 5-36, 7.

<sup>340</sup> Walters (note 339 above) 12.

<sup>341</sup> S 264 (1) of the Insolvency Act 1986.

<sup>342</sup> S 265 of the Insolvency Act 1986.

rather than three years under the old regime, and it allows for an earlier discharge where the Official Receiver deems fit.<sup>343</sup> Bankruptcy may seem like a better option due to the provision for discharge, however, it does have some adverse effect on individual debtors, such as, that homeowners may lose their homes, the cost of filing for bankruptcy is normally high, and when accessing credit, a bankrupt will have to disclose his status.<sup>344</sup>

### **6.3.3 Individual Voluntary Arrangement (IVAs)**

Individual voluntary arrangements (IVAs) are the main formal alternative to bankruptcy.<sup>345</sup> Part VIII of the Insolvency Act regulates IVA. An IVA commences where a debtor who wishes to achieve a resettlement of his debts makes a proposal to his creditors. Section 258 provides that a creditors' meeting summoned under section 257 shall decide whether to approve or reject the proposed voluntary arrangement.<sup>346</sup> In the payment of his debts, the debtor can agree to contribute assets or surplus income or a combination of both.<sup>347</sup> An IVA binds the debtor and his creditors on the terms of the agreement.<sup>348</sup> Where a debtor has complied with the terms of the IVA he receives a discharge from all unsecured debts that were outstanding at the commencement of the IVA.<sup>349</sup>

Importantly, an IVA or an application thereof stays a bankruptcy petition, execution or other legal process that may be commenced or continued against the debtor or his property except with the leave of the court.<sup>350</sup> In certain circumstances, the court has discretion to make a bankruptcy order under a petition where *inter alia*: the debtor fails to comply with his obligations under the IVA plan; the information given by the debtor was false or certain material information was omitted; or the debtor has failed to fulfil his obligations as required by the supervisor of the IVA plan.<sup>351</sup> IVAs are often proposed by a debtor who seeks to avoid bankruptcy and one of the advantages of an IVA over bankruptcy is that a debtor may keep

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<sup>343</sup> Walters (note 339 above) 14.

<sup>344</sup> Skene and Walters 'Consumer Bankruptcy Reform in Scotland, England and Wales' 10 (July 6, 2006); available at <http://ssrn.com/abstract=914522> (accessed on 3 October 2015).

<sup>345</sup> Skene and Walters (note 344 above) 11.

<sup>346</sup> S 258 of the Insolvency Act 1986.

<sup>347</sup> S 258 of the Insolvency Act 1986.

<sup>348</sup> Skene and Walters (note 345 above) 11.

<sup>349</sup> Skene and Walters (note 345 above) 12.

<sup>350</sup> S 252 (2) of Insolvency Act 1986.

<sup>351</sup> S 276 (1) of the Insolvency Act 1986.

his home.<sup>352</sup> However, in recent years IVAs have been criticised for having a protracted completion time period, ranging from an average of five and a half years.

#### **6.3.4 County Court Administration Orders (CCAOs)**

A CCAO is a court-based debt management solution that was introduced to facilitate the recovery of small debts and is designed to assist debtors with relatively small income and limited assets.<sup>353</sup> CCAOs are only available to debtors with debts not exceeding £5,000 and with not more than one judgment debt. According to section 112J of the County Courts Act 1984, only a court can make an administration order on the strength of the application made by the debtor.<sup>354</sup> Section 112 (6) of the Act provides that an administration order allows a debtor to make payment of the debt either in instalments, or in full, depending on his circumstances.<sup>355</sup> If the debtor pays his debts in full in terms of the order, the remaining balance of the debts may be discharged in terms of section 117 of the County Courts Act.<sup>356</sup> The administration order is not designed to last indefinitely. Section 112K of the Act states that the maximum period permitted is five years. However, this is subject to any variation or revocation of the order.<sup>357</sup>

An administration order does not co-exist with other debt management arrangements and other debt relief options cease to be in force when an administration order is made.<sup>358</sup> Administration orders also stay all legal proceedings. Once an administration order has been made, no creditor will have any remedy against the person or property of the debtor in respect of any debt of which the debtor notified the court before the administration order was made or which has been scheduled to the order.<sup>359</sup> Administration orders also freeze charges and interest.<sup>360</sup> The disadvantage of this debt relief option is that it has a low completion rate and, as a result, in practice only few debtors ultimately receive a discharge.<sup>361</sup>

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<sup>352</sup> Skene and Walters (note 344 above) 13.

<sup>353</sup> Skene and Walters (note 345 above) 16.

<sup>354</sup> S 112J of the County Courts Act 1984.

<sup>355</sup> S 112 (6) of the County Courts Act.

<sup>356</sup> Skene and Walters (note 344 above) 16.

<sup>357</sup> S 112K of the County Courts Act.

<sup>358</sup> S 112L of the County Courts Act.

<sup>359</sup> S 114 of the County Courts Act.

<sup>360</sup> Skene and Walters (note 344 above) 16.

<sup>360</sup> Skene and Walters (note 344 above) 16.

<sup>361</sup> Skene and Walters (note 344 above) 16.

### 6.3.5 Debt Relief Orders (DROs)

Debt relief options for debtors with no income and assets became effective on the 6<sup>th</sup> of April 2009 and were inserted into the Insolvency Act 1986 through the Tribunals, Courts and Enforcement Act 2007.<sup>362</sup> A qualifying debtor has a total liabilities of less than £15 000; a maximum surplus income of £50 per month after paying normal household expenses; and assets of no more than £300. If the debtor owns a motor vehicle, it may not be worth more than £1 000.<sup>363</sup> The above requirements of the DRO have been criticised for being too rigid. Although this debt relief option was introduced to come to the aid of the low income and low assets debtors, its requirements are said to be ‘unnecessarily restrictive and unjustifiable’.<sup>364</sup>

This debt relief option is extra-judicial and courts play no role whatsoever in the process. The official receiver makes the order and once this has occurred, there is a moratorium placed on all debts owed by the debtor and a creditor cannot commence bankruptcy proceedings.<sup>365</sup> During this moratorium period a debtor is subject to the same restrictions as bankruptcy.<sup>366</sup> The moratorium will endure for a year and thereafter the debtor receives a discharge.<sup>367</sup>

### 6.4 Comparative Comments

Following comments are made with focus on three aspects of consumer insolvency in South Africa which remain areas of concern, as identified in earlier chapters. Neither the United States of America nor England and Wales employs a requirement of ‘advantage to creditors’ in their consumer insolvency law system. This requirement has remained an important feature in the South African’s consumer insolvency system and has met with a great deal of criticism from writers of this area of law.

In the United States of America, BAPCPA introduced a means test which determines which debt relief option is appropriate for each debtor, taking into account his unique circumstances.<sup>368</sup> The means test is not a blanket rule as it is only applied where the debtor’s

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<sup>362</sup> Roestoff and Coetzee, ‘Consumer Debt Relief in South Africa; Lessons from America and England; and Suggestions for the Way Forward’ (2012) 24 *SA Merc LJ* 53-76, 73.

<sup>363</sup> Roestoff and Coetzee (note 362 above) 73.

<sup>364</sup> Ramsay and Spooner, ‘Insolvency proceedings: Debt relief orders and bankruptcy petition limit’ Submission to the Insolvency Service’s call for evidence 2 (on file with author).

<sup>365</sup> Roestoff and Coetzee (note 362 above) 74.

<sup>366</sup> Roestoff and Coetzee (note 362 above) 64.

<sup>367</sup> Roestoff and Coetzee (note 362 above) 74.)

<sup>368</sup> See 6.2.2 above.

gross income exceeds the median income in his state of residence.<sup>369</sup> In such a case, where his disposable monthly income is more than the amount allowed, he does not qualify to file for chapter 7. On the other hand, in South Africa the determining factor for a debtor who is applying for voluntary surrender and in compulsory sequestration is whether sequestration will yield an advantage to creditors. It is evident that the former enquiry, using a means test, is more focused on the debtor and the latter leans more towards the benefit of the creditors. Thus we can see the different approach adopted by these two jurisdictions.

Secondly, the consumer insolvency regime in South Africa can be distinguished from the US system on the basis of the absence of the fresh start principle in our system. A debtor may only receive a discharge when his estate is sequestrated. Further, such discharge is a consequence of sequestration and not the primary objective of our insolvency law.<sup>370</sup> Alternatives to sequestration, namely, debt review and administration orders do not provide for a discharge and therefore debtors will not receive a fresh start.<sup>371</sup> Clearly, the American bankruptcy regime's policies and principles are more liberal and debtor friendly, compared to the South Africa's consumer insolvency law system which is creditor oriented.<sup>372</sup> Discharging the debtor from his pre-petition debts is a feature in both chapters 7 and 13 of the Bankruptcy Code which provide for liquidation and a repayment plan respectively. In South Africa, discharge only occurs as a consequence of rehabilitation in terms of the Insolvency Act.

Thirdly, the debt relief options available to debtors in the United States of America allow for an automatic stay in relation to any proceedings against a debtor and creditors are therefore precluded from instituting proceedings against a debtor and his property.<sup>373</sup> However, in certain circumstances bankruptcy proceedings under chapter 7 can be bought while a debtor is subject to chapter 13.<sup>374</sup> In South Africa, a debtor's resorting to one of the debt relief options that serve as alternative to sequestration does not preclude a creditor from instituting sequestration proceedings against the estate of his debtor.<sup>375</sup> In the result, even if a debtor would prefer to retain his assets keep and does have a regular income to make payments in

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<sup>369</sup> Skene and Walters (note 344 above) 73.

<sup>370</sup> See 2.3.2.

<sup>371</sup> See 3.3.2 and 4.5.1.

<sup>372</sup> Skene and Walters (note 344 above) 37.

<sup>373</sup> See 6.2.2 and 6.2.3.

<sup>374</sup> See note 331.

<sup>375</sup> See 5.2.2; note 241; *Investec v Mutemeri*; *Naidoo v Absa*; and *FirstRand Bank v Kona*.

terms of a debt re-arrangement plan under the NCA or an administration order under section 74 of the MCA, the court may grant a sequestration order against his estate. This is an unfortunate state of affairs for consumer debtors in South Africa. Steyn comments that it is a great concern that the consumer insolvency procedure by the Insolvency Act and the other debt relief options do not conform to internationally recognised principles and recommendations in relation to rehabilitation procedures.<sup>376</sup> The INSOL Consumer Debt Report examines the principles in which the consumer insolvency law should be based and recommends that such principles be equally applicable to all jurisdictions.<sup>377</sup> The principles in the INSOL report, recommend *inter alia* that a debtor receive some form of discharge from indebtedness and or be offered a ‘fresh start’ and a debtor be given the opportunity to choose between a liquidation procedure or rehabilitation procedure.<sup>378</sup> The INSOL report also recommends that creditors be precluded from going after the debtor who is subject to any debt re-arrangement or restructuring.<sup>379</sup> The consumer insolvency systems of the two jurisdictions that have discussed appear to be in line with most of international principles and recommendations of the INSOL report.

As stated in this paper, South Africa’s debt relief options lack fundamental aspects including the lack of provisions for discharge which is evident in other jurisdictions. Therefore, a debtor in South Africa may be indebted for the rest of his life with no possibility of being discharged. In England and Wales there are a variety of debt relief options which cater for a range of debtors depending on their level of indebtedness and such options have discharge provisions<sup>380</sup> Although there is such variety in England and Wales, their debt relief options have been criticised for being complicated and not giving many debtors that opportunity of a ‘fresh start’.<sup>381</sup>

Although, there has been criticism on the debt relief options in England and Wales, there are still positive aspects as compared to the insolvency system in South Africa. The statutory

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<sup>376</sup> Steyn (note 5 above) 214.

<sup>377</sup> INSOL International *Consumer Debt Report II* Report of Findings and Recommendations 3. See also World Bank *Report on the Treatment of the Insolvency of Natural Persons* 2012 (available at <[www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2013/05/02/000333037\\_20130502131241/Rendered/PDF/771700WP0WB0In00Box377289B00PUBLIC0.pdf](http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2013/05/02/000333037_20130502131241/Rendered/PDF/771700WP0WB0In00Box377289B00PUBLIC0.pdf)> )

<sup>378</sup> INSOL *Consumer Debt Report* (note 377 above) 11-12.

<sup>379</sup> INSOL *Consumer Debt Report* (note 377 above) 14.

<sup>380</sup> See 6.3.2 note 344.

<sup>381</sup> Ramsay and Spooner (note 364 above) 3.

debt relief options in England and Wales, unlike South Africa provide for an automatic stay in all legal proceedings against a debtor whose debts are being restructured under the IVAs or the CCAOs. Creditors cannot petition for the debtor's bankruptcy or bring any claim against the debtor except with the leave of court. In South Africa, however, the position is remarkably different. Until recently, a debtor who applied for any of the two debt relief options was deemed to have committed an act of insolvency and as a result a creditor could apply for the sequestration of the debtor's estate. This issue has now been resolved by the enactment of the new section 8A of the Insolvency Act, however, section 8A applies only to a debtor who applies for debt review and a debtor who applies for an administration order is not protected.<sup>382</sup> Further, a debtor who is subject to debt review or administration is not protected from a creditor who wishes to apply for the sequestration of his estate. The decisions in *Naidoo v Absa* and *Investec v Mutemeri* have confirmed this position in our law.<sup>383</sup>

## 6.5 Conclusion

This chapter has set out and discussed the debt relief systems in the United States of America and England and Wales in order to highlight differences with a view to determining how their provisions can be adopted into our own system to provide adequate debt relief options for our consumer debtors. In the United States of America the provisions are more debtor-friendly and the requirements for 'straight bankruptcy' under chapter 7 are not as stringent as compared to our 'advantage to creditors' requirement. Further, the repayment plan under chapter 13 is also debtor-friendly and both chapter 7 and 13 contain provisions that allow debtors to be discharged at the end. The same may be said with regard to the debt relief options available in England and Wales. The provisions are more debtor-friendly and, in England and Wales, a debtor may be discharged after only one year in the bankruptcy proceedings. However, the IVAs have been criticised for their long completion period which takes as long as six to seven years for a debtor to complete the plan.<sup>384</sup> This is seen as a concern in respect of a debtor's rehabilitation and the fresh start policy. The same concern has been raised in respect of DROs as it has been said the requirements for this debt relief are similarly stringent as those on bankruptcy.<sup>385</sup>

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<sup>382</sup> See 5.2 above

<sup>383</sup> See 5.2 above.

<sup>384</sup> See 6.3.3 above.

<sup>385</sup> Ramsay and Spooner (note 364 above) 1.

A common thread in the United States of America and in England and Wales is the barring of any proceedings instituted against a debtor who has applied for any statutory debt relief option that is not in the form of 'straight bankruptcy'. A significant difference, when comparing debt relief options available to debtors in South Africa and those available in the United States of America and in England and Wales, is that South Africa remains a pro-creditor system where the others have shifted towards enacting provisions that are debtor-friendly.

## CHAPTER 7

### CONCLUSION AND RECOMMENDATIONS

#### 7.1 Conclusion

This dissertation has provided an overview of the insolvency law in South Africa as well as other debt relief options that are available for a consumer debtor who is experiencing financial problems. In our current consumer insolvency law regime an over-indebted debtor may either elect to utilise the machinery of the Insolvency Act, provided that he can satisfy the advantage to creditors requirement, or alternatively apply for debt review under the NCA or an administration order in terms of the MCA.

It has already been established that sequestration is not a debt relief option available to every debtor and this is largely due to the requirement to prove advantage to creditors.<sup>386</sup> Further, the discretionary power exercised by the courts when adjudicating on applications for sequestration, especially voluntary surrender, is also a significant factor as regards whether a debtor is able to use this machinery or not. In *Ex Parte Ford*, it was evident how reluctant courts are to grant voluntary surrender orders. This case also showed evidence of the creditor-oriented approach adopted by our courts. Thus it is clear that our insolvency system and our courts protect the interests of the creditors more than those of the debtors.

A further challenge for debtors who are unable to satisfy the stringent requirements of the Insolvency Act is that even the alternatives to sequestration are also creditor friendly. The objectives of the NCA make it clear that a debtor must fulfil his financial obligations wholly and not partially.<sup>387</sup> Similarly, administration orders are also creditor oriented because a debtor is required to make payments under the administration order until he has satisfied all his debts.<sup>388</sup>

The creditor oriented approach yields a further result: the issue of lack of provision for debtors to receive discharge under debt review or on an administration order. The Insolvency Act is the only debt relief option that provides for discharge. However, it may be noted that discharge is a consequence of sequestration and not the primary objective of the Insolvency

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<sup>387</sup> See 4.2 above.

<sup>388</sup> See 3.2 above.

Act.<sup>389</sup> As stated earlier in the paper neither debt review nor administration orders offer discharge to debtors subject to their completion of their repayment plan. The lack of such provision may result in debtors being indebted for the rest of their lives. This is an adverse position that any debtor may find himself in and many authors concur that South African's consumer insolvency law requires reform.<sup>390</sup>

The comparative section in this paper brought in the spotlight that both the United States of America and England and Wales have more debtor friendly consumer insolvency law systems. Particularly the United States of America's insolvency system is underpinned by the principle of 'fresh start', which is designed to discharge honest debtors. England and Wales similarly has debtor friendly provisions, although some shortfalls have been identified in the IVAs and DROs, the insolvency in these two jurisdictions remain more debt friendly than that of South Africa. The international principles of insolvency also advocate that debtors receive a discharge from their financial obligations after a certain period.<sup>391</sup> Further, these principles recommend that a consumer insolvency system must allow debtors to choose between a liquidation procedure and rehabilitation procedure which include restructuring procedure.<sup>392</sup> These principles recommend that creditors be prohibited from pursuing the debtor during any liquidation and rehabilitation procedure.<sup>393</sup> Contrary to this, our courts have set a precedent that goes against most of these international principles. Although the new section 8A of the Insolvency Act now prevents a creditor from applying for the sequestration of his debtor's estate, where the debtor has applied for debt review, a debtor who is subject to an administration order is not protected from a creditor who wants to sequester his estate.

It may be concluded that our law is not consonant with these international principles as our alternative debt relief options do not protect a debtor from having his estate sequestered. A debtor who wishes to retain his assets and apply for debt review, in lieu of liquidation as a consequence of sequestration, may end up losing the very assets he is trying to protect. From

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<sup>389</sup> See 2.5 above.

<sup>390</sup> See 1.1 above. See also Boraine and Roestoff, 'Revisiting the state of consumer insolvency in South Africa' (part 2), (note 194 above) 327, where it was noted that 'when considering the proposals of the 2010 Insolvency Bill, it is apparent that little has changed from the current Insolvency Act and it is clearly does not introduce a revolutionary new insolvency regime.

<sup>391</sup> See 6.4 above note 378.

<sup>392</sup> See 6.4 above note 378.

<sup>393</sup> See 6.4 above.

the discussion of the two foreign jurisdictions selected, it appears that both of them allow for automatic stay and no creditor may go against the debtor or his property. Thus a debtor's home and property is protected during the subsistence of any debt restructuring plan.

## **7.2 Recommendations**

It is acknowledged that South Africa's consumer insolvency does not provide adequate debt relief for debtors and that reform is required to address the shortcomings in our system.<sup>394</sup> Therefore, there is a need for legislative intervention in order to bring South Africa's consumer insolvency regime in line with international principles and to make it consonant with the approach followed by other foreign jurisdictions. Although the legislature has attempted to provide a solution on the conflict between the Insolvency Act and the NCA by enacting section 8A, this appears not be adequate, as the new section 8A only covers debtor who applies for debt review not administration order. It is thus recommended that the legislature intervene and adopt ideas from foreign jurisdictions to address some of the shortcomings experienced by our own insolvency system. The legislative intervention could either be in a form of amending the existing legislation or enacting new legislation.<sup>395</sup> It is recommended that when the legislature adopt ideas from foreign jurisdictions, be mindful of our unique demographics, history and socio economic differences.<sup>396</sup>

First, it is recommended that the current provisions of both the NCA and the Insolvency Act be amended to preclude a creditor from applying for the sequestration of his debtor's estate, where the debtor has applied for, or is subject to, debt review. We have seen evidence that the modern trend is to stay legal actions including sequestration against debtors who are subject to restructuring or repayment plans. It is recommended that the legislature amend or enact provisions similar to those of the United States of America and of England and Wales, which will create an automatic stay on any proceedings including sequestration, against the debtor by the creditor. The automatic stay should be effective from the time the debtor makes an application for the re-arrangement of his debts and there should be a regulated body that will work with debt counsellors and administrators to expedite the process since there is a risk of having a backlog.

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<sup>394</sup> See note 6.

<sup>395</sup> Maghembe (note 241 above) 178-179, See also Steyn (note 5 above) 216.

<sup>396</sup> Coetzee and Roestoff, 'Consumer debt relief in South Africa – Should the Insolvency system provide for NINA debtors? Lessons from New Zealand' (note 1 above) 5.

Secondly, it is recommended that the NCA and section 74 of the MCA be amended to allow debtors to receive discharge after a certain period. As it stands, there is no incentive for debtors, particularly honest ones who become over-indebted through the misfortunes of life, to enter into these repayment plans. Further, the abuse of process in insolvency proceedings as evidenced by the case law may be attributed to the fact that there is no other debt relief option that offers a debtor a discharge from his pre-sequestration debts.<sup>397</sup> It then follows that debtors see insolvency as their only way out. It is recommended that the debt relief options be revised in order to be in line with the international principles so as to offer discharge to a debtor who undergoes any debt restructuring plan.

Thirdly, it is recommended that the advantage to creditors requirement be done away with and/or the alternatives to sequestration be amended to have more debtor friendly provisions. In this way debtors who cannot satisfy the requirement may still find relief using the alternative statutory measures available. Therefore, it is recommended that the legislature amend or enact new provisions that will be more debtor friendly ones which will offer a 'fresh start' to debtors. The advantage to creditors requirement is an old principle underpinning the Insolvency Act and thus reviewing this principle, to examine if it still has a place in the modern consumer insolvency regime, would prove to be a worthy exercise. Evans rightfully submitted that courts have an inherent discretion to prevent abuse of its process.<sup>398</sup> Thus if the advantage to creditors requirement is done away with, courts will still have the discretion to refuse a sequestration application on the ground that it appears *prima facie* to be an abuse of court process or is not instituted *bona fide*.

It is recommended that in order for the Insolvency Act to be available to every debtor even the indigent one. The yardstick should no longer be one that is to the advantage of creditors but be the one that balances the interests of both the debtors and creditors. The recommended approach is that, instead of a debtor showing the court that the sequestration will be to the advantage to creditors, the court must look at the application based on its own facts and circumstances and make findings on whether such an application balances the interests of the creditors *and* those of the debtors. If the sequestration will benefit both the debtor and the creditors and it is not an abuse of the process the court should grant the order. If however, the sequestration application will not benefit both the debtor and his creditors, the court may

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<sup>397</sup> See 2.4, *Mthimkhulu v Rampersad, Craggs v Dedekind, Plumb on Plumbers v Lauderdale*.

<sup>398</sup> Evans, 'Friendly sequestration, the abuse of process of court' (note 18 above) 18.

refer the matter to be dealt with by debt review or section 74 of the MCA. It is recommended that this approach be applied to both voluntary surrender and compulsory sequestration. If the application is an abuse of process the court should not grant the sequestration order nor should the court refer the matter.

Internationally, insolvency law has shifted towards a more debtor friendly approach and South Africa, whose approach remains largely creditor oriented, should follow suit.

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